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## THE IMPORTANCE OF DEFINITIONS IN THE DEVELOPMENT OF PROFESSIONAL COMPETENCE: AN EXAMPLE FROM ACCOUNTING

***Annotation.** Sometimes even very reliable sources can have inaccuracies that often go undetected for years if not decades. It is especially bad if the use of professional definitions turns out to be incorrect. The article discusses one such case.*

***Key words:** income, gain, expenses, loss, profit.*

***Анотація.** Іноді навіть дуже надійні джерела можуть містити неточності, які часто залишаються непоміченими роками, якщо не десятиліттями. Особливо погано, якщо використання професійних визначень виявиться некоректним. У статті йдеться про один із таких випадків.*

***Ключові слова:** дохід, прибуток, витрати, збиток, прибуток.*

**Introduction.** In accordance with the definitions, used in *International Financial Reporting Standards (IFRSs)*, until 2018 income encompassed both *revenue* and *gains* and definition of expenses encompassed both *loss* and other *expenses*.

In 2018, according to the decision of the *International Accounting Standards Board* that the implication that the *Conceptual Framework* defines subclasses of income and expenses is unhelpful [6] the pair of terms *gain-loss* was removed from the *Glossary of IFRS terms* [7] and the *Conceptual Framework for Financial Reporting* [9].

No official explanation has been given for this. We will try to explain this with a simple example using a problem-solving approach.

**The only purpose of this article** is to find out what is actually denoted by the pair of terms *gain-loss*.

Other issues, related to the definition of *gain* and *loss*, such as the different understanding of the term *income* in the USA and IFRSs, and the use of the term *loss* in IFRSs in two completely different meanings have been discussed by the authors of current article in [1 - 4].

**Example of Problem-solving.** The *Business Company* bought the *Device* in the beginning of the year (January 2, 20X4) for 15,000 €. The estimated usage life is 5 years. The expected residual value (terminal value) is 0. On January 2, 20X5, the *Device* was sold for 10,500 €.

The depreciation is computed by using:

- 1) straight-line method;
- 2) double declining (double diminishing) balance method;
- 3) 150% declining balance (diminishing balance, reducing balance) method (depreciation rate is 30%).

**Version 1: Journal entries when using the straight-line method for depreciation (depreciation rate 20%)**

<b>Depreciation for the year 20X4</b>		
Dr: Depreciation expense	3,000 €	
Cr: Accumulated depreciation		3,000 €

<b>Net book value of the <i>Device</i> on December 31, 20X4</b>	
<i>Device</i>	15,000 €
<u>Accumulated depreciation</u>	<u>(3,000 €)</u>
Net book value (depreciated cost)	12,000 €

Since the *Business Company* no longer has the *Device*, the related information must also be eliminated.

The following are the regular steps in composing a compound journal entry:

1. Cash inflow from the sale of the *Device* (Dr: Bank account 10,500 €).
- 2–3. Eliminating the *Device* from the balance sheet (Dr: Accumulated depreciation 3,000 € and Cr: *Device* 15,000 €).

<b>Journal entry</b>		
Dr: Bank account	10,500 €	
Dr: Accumulated depreciation	3,000 €	
<b>Dr: <i>Debit Balancer</i></b>	<b>1,500 €</b>	
Cr: <i>Device</i>		15,000 €

**Comment.** Luca Pacioli, the “father” of double entry, already in the 15th century formulated the rule that **totals of debits and credits must be equal**. In our case, this rule was not followed.

So, it is necessary to **increase *Debit side* by 1,500 €**. For this we use an account with a conditional name *Debit Balancer* or *Debit Equalizer*.

**Version 2: Journal entries when using the double-declining balance method for depreciation (depreciation rate 40%).**

<b>Depreciation for the year 20X4</b>	
Dr: Depreciation expense	6,000 €
Cr: Accumulated depreciation	6,000 €

<b>Net book value of the Device on January 2, 20X5</b>	
<i>Device</i>	15,000 €
<u>Accumulated depreciation</u>	<u>(6,000 €)</u>
Net book value (depreciated cost)	9,000 €

The following are the regular steps in composing a compound journal entry:

1. Cash inflow from the sale of the *Device* (Dr: Bank account 10,500 €).
- 2–3. Eliminating the *Device* from the balance sheet (Dr: Accumulated depreciation 6,000 € and Cr: Device 15,000 €).

<b>Journal entry</b>	
Dr: Bank account	10,500 €
Dr: Accumulated depreciation	6,000 €
Cr: <i>Device</i>	15,000 €
<b>Cr: <i>Credit Balancer</i></b>	<b>1,500 €</b>

**Comment.** The totals of debits and credits are not equal. It is necessary to **increase *Credit side* by 1,500 €**. For this we use an account with a conditional name *Credit Balancer* or *Credit Equalizer*.

**Version 3: Journal entries when using of 150% declining balance method for depreciation (depreciation rate 30%).**

<b>Depreciation for the year 20X4</b>	
Dr: Depreciation expense	4,500 €
Cr: Accumulated depreciation	4,500 €

<b>Net book value of the <i>Device</i> on January 29, 20X5</b>	
<i>Device</i>	15,000 €
<u>Accumulated depreciation</u>	<u>(4,500 €)</u>
Net book value (depreciated cost)	10,500 €

The following are the regular steps in composing a compound journal entry:

1. Cash inflow from the sale of the *Device* (Dr: Bank account 10,500 €).

2–3. Eliminating the *Device* from the balance sheet (Dr: Accumulated depreciation 4,500 € and Cr: Device 15,000 €).

<b>Journal entry</b>	
Dr: Bank account	10,500 €
Dr: Accumulated depreciation	4,500 €
Cr: <i>Device</i>	15,000 €

**Comment.** The totals of debits and credits are equal. This means **no need for adjustment**.

**Final conclusions.** Initial numerical data are the same for all three versions:

- We dealt with the same *Business Company*.
- The same *Device* was bought for 15,000 €.
- The estimated usage life of *Device* was 5 years.
- The expected residual value (terminal value) was 0.
- One year after purchase the *Device* was sold for 10,500 €.

If do not think in terms of accounting, all three versions are identical. The only difference is in depreciation formulas used.

One of the main features of such elements of financial statements as *assets*, *liabilities*, *income* and *expenses* is measurability. **Credit Balancer (Credit Equalizer)** and **Debit Balancer (Debit Equalizer)** are not measurable and do not meet the definition of income and expenses, respectively. They are simply figures, whose purpose is to make totals of debits and totals of credits equal in a journal entry. The obvious need for balancing journal entries is caused by the nature of double entry. Since the IFRSs use the term *Gain* instead of **Credit Balancer (Credit Equalizer)** and the term *Loss* instead of **Debit Balancer (Debit Equalizer)**, the phenomena expressed by them are also not measurable, because despite the name difference, the content remains the same!

Professor Richard Barker has noted that «... the standards that deal with gains require net measurements, that is, a gain is calculated as the difference between two values» [5]. According to the IAS 16 Property, Plant and Equipment, para. 71 «The gain or loss arising from the derecognition of an item property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item» [8]. The illogicality of this requirement lies in the need to make calculations. According to the *transaction approach* used by the authors of this paper, there is no need to make calculations. It is simply necessary to balance (equalize) the totals of the debit side and the credit side of the compound journal entry.

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