MEASUREMENT OF BUSINESS INCOME IN MSME SECTOR: A CONCEPTUAL ANALYSIS

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Abstract

Income measurement is one of the most important purposes of maintaining account in MSME sector. The measurement analyses the past and present activities and acts-as future guidance. But accountants are not unanimous in the choice of a single term to denote what income signifies a large number of terminologies such as income profit, receipts, earning surplus, gains, revenues, etc. are found to be used to convey the tendency in business practice has been to discard the word ‘income’. In this paper we shall sketch the broad outlines of the controversies existing between accountants and economists with regard to their approaches on income measurement and to highlight the economic problems of measuring business income.

Key Words: MSME, Income, Measurement, Cost of Production

INTRODUCTION

Income measurement is one of the most important purposes of maintaining account in MSME sector. The measurement analyses the past and present activities and acts-as future guidance. But accountants are not unanimous in the choice of a single term to denote what income signifies a large number of terminologies such as income profit, receipts, earning surplus, gains, revenues, etc. are found to be used to convey the tendency in business practice has been to discard the word ‘income’. In recent years, the tendency in business practice has been to discard the word ‘profit’. And to use such a neural expression as business income’ which, though ambiguous in itself, is more amenable to measurement of business income. In this paper we shall sketch the broad outlines of the controversies existing between accountants and economists with regard to their approaches on income measurement and to highlight the economic problems of measuring business income.

In the accounting sense, profit is an ex-post concept. It may be ascertained by setting against the income earned, the concept of earning it. Accountants adopt conventions and define their terms by enumeration. They resort to past transactions and eschew speculation. Conventional accounting is largely concerned with historical profits rather than anticipated profits. This type of accounting is most vital for tax purposes and for purposes of reporting to owners, creditors and others on the state of the firm. It has some relevance in making decisions for the future, but is not basic to the problems of choosing future courses of action. The strict meaning of profit is, therefore, rarely observed in drawing up the books of account because certain assumptions have become so customary that it is difficult to depart from them.

As against this, economists disagree with conventional techniques and define their terms functionally. They argue that the business firm, as a going concern, is primarily interested in knowing what its resources would yield in alternative uses in the future. Accounting as understood and practised, does not provide this information, hence, its conventions have little economics significance and are inadequate for a penetrating analysis. An economic balance sheet is derived essentially from income expectation. For an economist, profit is an ex-ante concept. It is a surplus in excess of all opportunity costs of the difference between the cash value of an enterprise at the beginning and end of a period. In the eyes of an accountant profit is an objectively measurable historical fact, but for an economist it is an arbitrary estimate. Most of these differences arise because of the difference in view point. The economist is basically interested in the theoretical analysis of profit. He claims that the true profitability of any investment or business operation cannot be accurately determined until it is wound up and that, for any intervening period, profits can only be estimated, which means that some of the costs and revenues have to be allocated arbitrarily. Through the estimates of profits by accountants and economists are as different as their approaches and objectives, both kinds of profits measurements are useful to management. They can at the most be supplanted but cannot be substituted. When it comes to the actual measurement of profit, the economists and the accountants mostly disagree on
Regarding he first of these controversies, we know that such non-cash items as the entrepreneur’s wages, rental income on land and the interest that the capital could earn elsewhere do not appear in the books of accounts. To determine profits, accountants only deduct explicit or paid out costs from the income. It is a common practice among economists to include in cost wages, rent and interest for all services employed in the business, including both those provided by the owner himself. A cording to them, the cost of production is a payment which is necessary to keep resources out of the next best alternative employment. They argue that the entrepreneur, who fails to obtain net revenue equal to his total cost, including imputed cost, would withdraw from business himself, his funds and property and invest them in another profitable undertaking to improve his position. Economic profit, therefore, is equal to accounting profit minus imputed costs. These discrepancies are quiet apparent in the case of individual pro-prorctoship business but are not too serious in the case of MSME. In such organisation management is usually hired, hence opportunity cost wages become a charge against gross revenue. Similarly, properties are generally rented, therefore, rent is taken in to consideration while determing profit. MSME, however, do not take into account the cost of the use of the economic profit by the amount of normal profit. This is the only significant discrepancy that exists between economic and accounting profits in the case of MSME.

**DEPRECIATION**

It is generally known that the equipment’s, machines and buildings get depleted with time and use. As time passes, these equipment’s become useless from the point of view of business. This calls for some provision for the future replacement of the machinery and equipment’s. Accountants make periodic depreciation changes to income to recover the cost of equipment and machinery before their usefulness is exhausted. The procedure is to estimate the useful life in years and to make the annual charge just large enough to recover the original cost with in the period. But the difficulty is that there is no single generally accepted method of depreciation and different MSME companies use different methods and this often vitiates the reporting of business profit. For economists, there are two distinct types of depression charges. The first the opportunity cost of equipment and the second the exhaustion of a year’s worth of limited valuable life. Bothe of these economic concepts of depreciation are important to management. The first opportunity cost is needed for operating problems of profit making the second, replacement of eroded earnings ability, is needed for financial problems of preserving and administrating capital. But in both cases original cost dose not play any role in estimates.

**CAPITAL GAINS AND LOSSES**

Capital gains and losses or windfall are often defined as unanticipated changes in the value of property relative to other real goods. Conservative MSME companies generally do not include capital gains until they are turned in to cash by a purchase or sale of assets, since it is never clear until then exactly how large they are in money terms. But at the same time, they invariable decide to write off capital losses from the current profit of the year in which the loss occurs. There are MSME sector that includes capital gains in the profit of the year in which the capital gains may accrue even though they are not returned into cash by selling. This shows that there can be discrepancies in the profit reported by different MSME companies because of the different approaches that they adhere to in the treatment of capital gains and losses.

**PRICE LEVEL CHANGE**

In measuring income, accountants typically state costs in terms of the price level at the purchase, by recording the historical outlays, rather than in terms of the current price level. Reasons such as:

1. Historical costs produce more accurate measurement of income;
2. Historical costs are more objective than the calculation of the present replacement value; (3) the function of the accountant is to record history whether or not history has relevance for future.
But this approach has certain defects in the sense that (1) the assets are undervalues in times of inflation and overvalued during period of deflation and (2) depreciation is understated and profit is overstated during inflation and vice versa.
For many enterprises, contemporary money profits can be approximated by a combination of replacement value depreciation and LIPO costing of materials. But a full correction of price level distortions requires separated deflation of all assets each year to rupees of constant purchasing power.
CONCLUSION

To sum up we can say that profit estimates play a central role in business decisions but in measuring profits accounts rely on historical cost rather than on current prices because they consider them more accurate, less debatable and befitting their purpose. Economists, on the other hand, are concerned with income, assets and net worth in future. Gross profit for the economist come much closer to the account’s net profits but the latter’s gross profit lie somewhere between not output or value added and profit. The net profits for the accountant are analogous to profit but for an economist, net profits are not in implicit expenses. “In general, the kind of profit measurement needed for most business decisions come closer to the ideal of economist than to the practice of the accountant”. Accountant’s charges depreciation on historical cost which is opposed by economist on the ground that during inflation, the cost refilling inventories, replacement of worn-out equipment and expanding practices fails to take this factor into consideration. The term ‘revolution accounting’, also known as ‘replacement value theory’ is used to overcome the problem of replacement, especially during periods of rising prices.

Accounting profits should not influence business decisions. If they are stretched too far, they are likely to cause confusion and distortions in the functioning of the enterprise. Modern accounting systems have begun to agree with the viewpoint of the economist but many farms still function under old conveniences, and therefore, there accounts details don’t present the true state of affairs and websites clearly. Perhaps, therefore, accounting should aim at giving several income figures rattler than one at setting out different pictures of firm side by side.

REFERENCES