Financial Accounting and its Implications in Present Corporate World

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Abstract

Accounting is a system meant for measuring business activities, processing of information into reports and making the findings available to decision-makers. The documents, which communicate these findings about the performance of an organisation in monetary terms, are called financial statements. Usually, accounting is understood as the Language of Business. However, a business may have a lot of aspects which may not be of financial nature. As such, a better way to understand accounting could be to call it The Language of Financial Decisions. The better the understanding of the language, the better is the management of financial aspects of living.

Many aspects of our lives are based on accounting, personal financial planning, investments, income-tax, loans, etc. We have different roles to perform in life—the role of a student, of a family head, of a manager, of an investor, etc. The knowledge of accounting is an added advantage in performing different roles. However, we shall limit our scope of discussion to a business organisation and the various financial aspects of such an organisation. When we focus our thoughts on a business organisation, many questions (is our business profitable, should a new product line be introduced, are the sales sufficient, etc.) strike our mind. To answer questions of such nature, we need to have information generated through the accounting process. The people who take policy decisions and frame business plans use such information. All business organisations work in an ever-changing dynamic environment. Any new programme of the organisation or of its competitor will affect the business. Accounting serves as an effective tool for measuring the financial pulse rate of the company. It is a continuous cycle of measurement of results and reporting of results to decisionmakers. Just like arithmetic is a procedural element of mathematics, book keeping is the procedural element of accounting. Figure 1 shows how an accounting system operates in business and how the flow of information occurs.

Over years, the art and science of accounting has evolved together with progress of trade and commerce at national and global levels. Professional accounting bodies have been doing intensive research to come up with accounting rules that will be applicable. Modern business is certainly more complex and continuous updating of these rules is required. We do see our parents keep track of monthly expenses. We make a distinction between payment done for monthly grocery and that for buying a house or a car. We understand that while grocery is a monthly expense and buying a house is like creating a resource that has indefinite future use.

Key words: JSW Group, steel, industry, AI, legal frame work, industrialization.

Introduction

The history of accounting can be traced back to ancient times. According to some beliefs, the very art of writing originated in order to record accounting information. Though this may seem to be an exaggeration, but there is no denying the fact that
accounting has a long history. Accounting records can be traced back to the ancient civilizations of China, Babylonia, Greece and Egypt. Accounting was used to keep records regarding the cost of labor and materials used in building great structures like the Pyramids. During 1400s, accounting grew further because the needs for information of merchants in the Veins City of Italy increased. The first known description of double entry book keeping was first published in 1994 by Lucas Pacioli. He was a mathematician and a friend of Leonardo Illeda Vinci. The onset of the industrial revolution necessitated the development of more sophisticated accounting system, rather than pricing the goods based on guesses about the costs.

Every stakeholder of the business is interested in a particular facet of information about the business. The art and science of accounting helps to put together these requirements of information as per universally accepted principles and also to interpret the results. It is interesting to note that each one of us has an accountant hidden in us. The increase in competition and mass production of goods led to the rise of accounting as a formal branch of study. With the passage of time, the corporate world grew. In the nineteenth century, companies came up in many areas of infrastructure like the railways, steel, communication, etc. It led to a rapid growth in accounting. As the complexities of business grew, ownership and management of business was divorced. As such, managers had to come up with well-defined, structured systems of accounting to report the performance of the business to its owners. Government also has had a lot to do with more accounting developments. The Income Tax brought about the concept of ‘income’. Government takes a host of other decisions, relating to education, health, economic planning, for which it needs accurate and reliable information. As such, the government demands stringent accountability in the corporate sector, which forces the accounting process to be as objective and formal as possible.

Objective:

This paper seeks to explore Financial Accounting and its implications in present corporate world.

UTILITY OF ACCOUNTING

The preceding section has just brought out the importance of information. Effective decisions require accurate, reliable and timely information. The need for quantity and quality of information varies with the importance of the decision that has to be taken on the basis of that information. The following paragraphs throw light on the various users of accounting information and what do they do with that information. Individuals may use accounting information to manage their routine affairs like operating and managing their bank accounts, to evaluate the worthwhileness of a job in an organization, to invest money, to rent a house, etc. Business Managers have to set goals, evaluate progress and initiate corrective action in case of unfavourable deviation from the planned course of action. Accounting information is required for many such decisions—purchasing equipment, maintenance of inventory, borrowing and lending, etc. Investors and creditors are keen to evaluate the profitability and solvency of a company before they decide to provide money to the organisation.

Therefore, they are interested to obtain financial information about the company in which they are contemplating an investment. Financial statements are the principal source of information to them which are published in annual reports of a company and various financial dailies and periodicals. Government and Regulatory agencies are charged with the responsibility of guiding the socio-economic system of a country in such a way that it promotes common good. For example, the Securities and Exchange Board of India (SEBI) makes it mandatory for a company to disclose certain financial information to the investing public. The government’s task of managing the industrial economy becomes simplify if the
accounting information such as profits, costs, taxes, etc. is presented in a uniform manner without any manipulation or ‘windowdressing’. Central and State governments levy various taxes.

The taxation authorities, therefore, need to know the income of a company to calculate the amount of tax that the company would have to pay. The information generated by accounting helps them in such computations and also to detect any attempts of tax evasion. Employees and trade unions use the accounting information to settle various issues related to wages, bonus, profit sharing, etc. Consumers and general public are also interested in knowing the amount of income earned by various business houses. Accounting information helps in finding whether or not a company is over charging or exploiting the customers, whether or not companies are showing improved business performance, whether or not the country is emerging from the economic recession, etc. All such aspects draw heavily on accounting information and are closely related to our standard of living.

**Changing land scape of financial accounting**

The main objective of Accounting is to provide financial information to stakeholders. This financial information is normally given via financial statements, which are prepared on the basis of Generally Accepted Accounting Principles (GAAP). There are various accounting standards developed by professional accounting bodies all over the world. In India, these are governed by The Institute of Chartered Accountants of India, (ICAI). In the US, the American Institute of Certified Public Accountants (AICPA) is responsible to lay down the standards. The Financial Accounting Standards Board (FASB) is the body that sets up the International Accounting Standards. These standards basically deal with accounting treatment of business transactions and disclosing the same in financial statements.

The following objectives of accounting will explain the width of the application of this knowledge stream:

(a) To ascertain the amount of profit or loss made by the business i.e. to compare the income earned versus the expenses incurred and the net result thereof.

(b) To know the financial position of the business i.e. to assess what the business owns and what it owes.

(c) To provide a record for compliance with statutes and laws applicable.

(d) To enable the readers to assess progress made by the business over a period of time.

(e) To disclose information needed by different stakeholders.

Accounting is considered to be a system which provides appropriate information to the Management for taking rational decisions. Of course, some non-accounting information is also useful for decision making. However, accounting provides a major and dependable data base for decision making. The basic objective of management of a business organisation is to maximise the wealth of its owners. This is also the objective of economics. Efficient use of scarce resources results in maximising the wealth of a nation. Thus, accounting and economics both have a similarity in the sense that both seek the optimum utilisation of resources of the firm or the nation, as the case may be. Moreover, the accountants have got the ideas such as value of assets, income, capital maintenance etc., from the economists. Of course, the accountants have suitably adapted these ideas keeping in view their own requirements and limitations. For instance, according to the economists, the value of an asset is the present value of all future earnings that can be derived from the asset.
However, it is a real difficult or almost impossible task for one to estimate correctly the future earnings particularly when an asset has a very long life—say, 50 years or more. The accountants have, therefore, adopted a realistic basis for valuation of asset—the cost or the price paid for the acquisition of the asset. Similarly, the accountants’ concept of marginal cost is different from the economists’ concept of marginal cost. According to the accountants, the marginal cost represents the variable cost, i.e., the cost which varies in direct proportion of output. Such cost remains fixed per unit of output. However, according to the economists the marginal cost refers to the cost of the producing one additional unit. Such cost per unit may increase or decrease depending upon the law of returns. For example, in case of law of increasing returns, the cost per unit would decrease while in case of law of decreasing returns, the cost per unit would increase.

Financial accounting present and future

The American Institute of Certified Public Accountants defines Accounting as “an art of recoding, classifying and summarizing in a significant manner and in terms of money, transactions and events which are in part at least of a financial character, and interpreting the results thereof.” The first step in the cycle of accounting is to identify transactions that will find place in books of accounts. Transactions having financial impact only are to be recorded. E.g. if a businessman negotiates with the customer regarding supply of products, this will not be recorded. The negotiation is a deal which will potentially create a transaction and will have exchange of money or money’s worth. But unless this transaction is finally entered into, it will not be recorded in the books of accounts. Secondly, the recording of the business transactions is done based on the Golden Rules of accounting (which are explained later) in a systematic manner. Transaction of similar nature are grouped together and recorded accordingly. e.g. Sales Transactions, Purchase Transactions, Cash Transactions etc. One has to interpret the transaction and then apply the relevant Golden Rule to make a correct entry thereof. Thirdly, as the transactions increase in number, it will be difficult to understand the combined effect of the same by referring to individual records. Hence, the art of accounting also involves the step of summarizing them. With the aid of computers, this task is simplified in today’s accounting world. The summarization will help users of the business information to understand and interpret business results. Lastly, the accounting process provides the users with statements which will describe what has happened to the business. Remember the two basic questions we talked about, one to know whether business has made profit or loss and the other to know the position of resources that are used by the business. It can be noted that although accounting is often referred to as an art, it is a science also. This is because it is based on universally applicable set of rules. However, it is not a pure science as there is a possibility of different

As mentioned earlier, financial accounting deals with the preparation of financial statements for the basic purpose of providing information to various interested groups like creditors, banks, shareholders, financial institutions, government, consumers, etc. Financial statements, i.e. the income statement and the balance sheet indicate the way in which the activities of the business have been conducted during a given period of time. Financial accounting is charged with the primary responsibility of external reporting. The users of information generated by financial accounting, like bankers, financial institutions, regulatory authorities, government, investors, etc. want the accounting information to be consistent so as to facilitate comparison. Therefore, financial accounting is based on certain concepts and conventions which include separate business entity, going concern concept, money measurement concept, cost concept, dual aspect concept, accounting period concept, matching concept, realization concept and conventions of conservatism, disclosure, consistency, etc. All such concepts and conventions would be dealt with detail in subsequent lessons. The significance of financial accounting lies in
the fact that it aids the management in directing and controlling the activities of the firm and to frame relevant managerial policies related to areas like production, sales, financing, etc. However, it suffers from certain drawbacks which are discussed in the following paragraphs. · The information provided by financial accounting is consolidated in nature.

It does not indicate a break-up for different departments, processes, products and jobs. As such, it becomes difficult to evaluate the performance of different sub-units of the organisation. · Financial accounting does not help in knowing the cost behaviour as it does not distinguish between fixed and variable costs. · The information provided by financial accounting is historical in nature and as such the predictability of such information is limited. The management of a company has to solve certain ticklish questions like expansion of business, making or buying a component, adding or deleting a product line, deciding on alternative methods of production, etc. The financial accounting information is of little help in answering these questions. The limitations of financial accounting, however, should not lead one to believe that it is of no use. It is the basic foundation on which other branches and tools of accounting analysis are based. It is the source of information, which can be further analysed and interpreted according to the tailor-made requirements of decision-makers.

Accountants in Public Practice and Corporate Scenario

The accountants in public practice offer their services for conducting financial audit, cost audit, designing of accounting system and rendering other professional services for a fee. Such accountants are usually members of professional bodies. In our country there are two recognised professional bodies for this purpose. They are (i) the Institute of Chartered Accountants of India and (ii) the Institute of Cost and Works Accountants of India. The accountants in public practice are also known as professional accountants. Such accountants are the members of the professional accounting bodies.

These accounting bodies usually require from their members the following:

(i) Getting themselves trained in the prescribed manner over a prescribed period.

(ii) Pass the examination conducted by the professional bodies.

(iii) Undertake to observe the generally accepted accounting principles enunciated by the professional bodies concerned.

(iv) Observe the Code of Ethics laid down by the concerned accounting body.

(v) Subject themselves to disciplinary proceedings whenever it is alleged that the member has violated the Code of Ethics laid down by the concerned body.

Adaptation of the education system to factor demands of Financial Accounting

In order to be able to meet the above-mentioned standards set for Industry 4.0, future employees must learn new key qualifications, but the educational system must also be adapted to these new framework conditions. There was agreement at the World Economic Forum 2016, for instance, that both schools and universities ‘should not teach the world as it was, but as it will be’.71 New qualification strategies for individual countries are thus needed. They must encourage students’ interest in subjects such as mathematics, information technology, science and technology when they are still in school, and teachers with digital competence must teach students how to think critically when using new media and help them to achieve a fundamental grasp of new digital and information devices.
Furthermore, increased use should be made of the design thinking method in order to encourage creative minds already at schools and universities. This method designates an integrated degree programme during which creative work at a company is accompanied by degree courses. Adaptability is one of the major challenges humans’ face, yet at the same time it can be a major strong point. The next generation of employees must learn to adapt quickly to the technical, social and digital change, because it is to be expected that even a ‘fifth industrial revolution’ will not be long in coming. Lifelong learning is the buzzword that applies not only to fully automated robots, but also to human beings! If an employee’s field of work is automated, the employee must be able to reposition or to distance himself or herself from the machine by individual skills.

Besides tried and tested school subjects and degree courses, more new degree courses and occupations requiring vocational training based on imparting extensive skills in IT, communication and sciences must be created. This includes data processing occupations, in particular. Although previous degree courses such as classic information technology or business information technology include numerous elements of significant importance for Industry 4.0, they deal too superficially with some aspects owing to their great variety, whereas other aspects are superfluous for the intended work. For example, ‘industrial cognitive science’ and ‘automation bionics’ are suggested as innovative degree courses that deal mainly with researching and optimising the interaction between robot systems and employees. In addition to the area of robotics, extended degree courses in the area of big data will be necessary. Employers’ demand for data artists and data scientists or big data developers is rapidly increasing. The main subjects for the professional field of data science include researching data of all types and their structures. Uniform education in this area is, however, still not available.

Governments are responsible not only for making education possible, but also for focusing young people’s interests on technical and IT jobs at an early age. This will increase the number of graduates in the long run. Ultimately, neither the ‘tried and tested’ nor the ‘new’ degree courses may focus solely on imparting specific technical knowledge. The employees of the future must, for instance, be given an understanding of the possibilities of technical aids. This applies, however, not only to theoretical background, but also to practical applications and thus handling the technical aids. US investors do not expect the new generation of employees to be technical geniuses, but employees should always be willing to learn new skills. A lifelong learning progress characterises the new labour market, which is changing rapidly because of technical development. The challenge for schools and universities is to teach the employees ‘soft skills’ that are becoming more important than ever, such as the ability to work in a team and to accept criticism, assertiveness, reliability, social and communicative skills and good time management. Learning ‘soft skills’ will prepare employees optimally for the future labour market: ‘To Switch the Skills, Switch the Schools.’

Conclusion

Accounting can be understood as the language of financial decisions. It is an ongoing process of performance measurement and reporting the results to decision-makers. The discipline of accounting can be traced back to very early times of human civilization. With the advancement of industry, modern day accounting has become formalized and structured. A person who maintains accounts is known as the accountant. He is engaged in multifarious activities like preparing financial statements, facilitating the control process, tax planning, auditing and information management. The information generated by accountant is used by various groups like, individuals, managers, investors, creditors, government, regulatory agencies, taxation authorities, employees, trade unions, consumers and general public. Depending upon purpose and method, accounting can be of broadly two types—financial accounting and management accounting. Financial accounting is primarily concerned
with the preparation of financial statements mainly for outsiders. It is based on certain well-defined concepts and conventions and helps in framing broad financial policies. However, it suffers from certain limitations which are taken care of by the other branch of accounting, viz.; management accounting. Management accounting is meant to help in decision-making by analyzing and interpreting the information generated by financial accounting. As such, management accounting is futuristic and decision-oriented. The methods of management accounting are not very exact as they have to be varied according to the requirements of the decision. Cost accounting is an important aspect of management accounting. It emphasizes on cost determination, aiding the planning and control process and supplying information for short- and long-run decisions. The basic differences between financial and management accounting arises due to differences in users of information, differences in time frame and type of reports generated. The criterion for decision making and the behavioural implications of both types of accounting are also different.

References