DAY ONE

Name _____ Date _____ Block _____

Read the article entitled “The Role of Accounting and Why It’s Important” and answer the following questions.

1. What is accounting? _____
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2. Why is accounting vital? _____
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3. Name and DESCRIBE the 3 key financial statements generated by accounting records.
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4. How does accounting help in evaluating the performance of a business?
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5. How does accounting help to ensure statutory compliance?
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6. How does accounting help to create a budget and future projections?
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7. How does accounting help in filing financial statements?
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The Role of Accounting in Business and Why It's Important

- February 19, 2019
- Dan Woods



The term accounting is very common, especially during tax season.

But before we dive into the importance of accounting in business, let's cover the basics – what is accounting?

Accounting refers to the systematic and detailed recording of financial transactions of a business. There are many types, from accounting for small businesses, government, forensic, and management accounting, to accounting for corporations.

Why Is Accounting Important?

Accounting plays a vital role in running a business because it helps you track income and expenditures, ensure statutory compliance, and provide investors, management, and government with quantitative financial information which can be used in making business decisions.

There are three key financial statements generated by your records.

- The income statement provides you with information about the profit and loss

- The balance sheet gives you a clear picture on the financial position of your business on a particular date.
- The cash flow statement is a bridge between the income statement and balance sheet and reports the cash generated and spent during a specific period of time.

It is critical you keep your financial records clean and up to date if you want to keep your business afloat. Here are just a few of the reasons why it is important for your business, big or small!

It Helps in Evaluating the Performance of Business

Your financial records reflect the results of operations as well as the financial position of your small business or corporation. In other words, they help you understand what's going on with your business financially. Not only will clean and up to date records help you keep track of expenses, gross margin, and possible debt, but it will help you compare your current data with the previous accounting records and allocate your budget appropriately.

It Ensures Statutory Compliance

Laws and regulations vary from state to state, but proper accounting systems and processes will help you ensure statutory compliance when it comes to your business.

The accounting function will ensure that liabilities such as sales tax, VAT, income tax, and pension funds, to name a few, are appropriately addressed.

It Helps to Create Budget and Future Projections

Budgeting and future projections can make or break a business, and your financial records will play a crucial role when it comes to it.

Business trends and projections are based on historical financial data to keep your operations profitable. This financial data is most appropriate when provided by well-structured accounting processes.

It Helps in Filing Financial Statements

Businesses are required to file their financial statements with the Registrar of Companies. Listed entities are required to file them with stock exchanges, as well as for direct and indirect tax filing purposes. Needless to say, accounting plays a critical role in all these scenarios.

DAY TWO

Name _____ Date _____ Block _____

Read the article “Objectives of Accounting” and answer the following questions.

Name and DESCRIBE the five (5) objectives of accounting.

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Objectives of Accounting

Every activity that a business firm does must be done for a reason and accounting is no exception. Accounting helps the company achieve a myriad of objectives. **Here is the list of objectives that accounting helps the company to obtain**.

- **Permanent Record**

  Any business firm needs a permanent record of the transactions that it indulges in. These records could be required for internal purpose, for taxation purpose or for any other purpose. Accounting serves this function. Whenever the organization commits any resource of monetary value either within the firm or outside the firm, a record is made. This permanent record is held on for years and can be retrieved as and when need be.

- **Measurement of Outcome**

  A business firm may indulge in numerous transactions every day. It may make profit in some of these transactions while it may make losses in some other transactions. However, the effect of all these transactions needs to be aggregated over a period of time. There must be daily, weekly and monthly reports which provides information to the organization about how well it is performing its activities. Accounting serves this purpose by providing periodic financial statements which help the firm adjust their operations accordingly.

- **Creditworthiness**

  Firms need resources for their functioning. They do not have any capital stock at hand and need to obtain them from investors. Investors will give money to the firm only if they have reasonable assurance that the firm will be able to generate enough profit. Past accounting records help a great deal in proving this. All kinds of investors from banks to shareholders ask for past accounting details before they trust the management with their money.

- **Efficient Use of Resources**

  Firms can also conduct useful internal analysis with the help of accounting data. Accounting records tell the firm what resources were committed to what activity and what time. These records also summarize the return that was obtained from these activities. Management can then analyze past behavior and draw lessons about how they could have performed better and used resources more efficiently.

- **Projections**

  Accounting helps management and investors look forward. Costs and revenue growths can be projected after substantial data has been accumulated. The assumption made is that the company is likely to behave exactly as it has done in the past. Thus, analysts can make reasonable assumptions about the future based on the past record.

DAY THREE

Name _____ Date _____ Block _____

Read the article “Who Uses Accounting?” and answer the following questions.

Name the various stakeholders and DESCRIBE how they use accounting data.

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Who Uses Accounting Data ?

Financial reporting is used by a wide variety of users for a wide variety of purposes. For this reason it has been difficult to set a common framework of accounting. The many stakeholders often have contrasting needs from accounting information. **Let's look at the stakeholders and their need for accounting data:**

- **Capital Markets:** Accounting information is widely used in the capital markets. The stock price moves up and down in relation to financial data. This is because the data provides most recent measure of a company's performance.

- **Lenders:** Lenders use accounting data to judge the creditworthiness of the firm. It is a common misconception that lenders against the feasibility of the project at hand. In reality, lenders look at the financial statements of the firm to find out whether the firm will be able to meet the loan obligations from its existing cash flow. Accounting data thus helps them hedge their risks.

- **Government:** Government has to tax the business at the profit that has been generated. Profit is the end result of preparation of Income Statement i.e. an accounting documents. Taxes are an expense for the organization. Therefore in all likelihood, corporations will try to reduce this liability by showing fewer profits. Thus the government also needs accounting data to ensure that they have been paid their fair share in taxation.

- **Employees:** Employees provide credit to the company in the form of their labour. They work immediately and expect payment at the end of the month, hence providing 15 days of average credit to the employer every month. They have a right to be concerned about the internal workings of the firm and whether they will be paid or not. Recent cases like the Kingfisher Airlines fiasco has brought to light the need that employees look at the financial statements of the companies that they work for. Employees of Kingfisher Airlines are struggling to make ends meet as their salaries have been delayed for months!

- **Managers:** Managers are in charge of controlling the operations of the firm. However, control largely depends on the availability of correct information at the correct time. This function is served by accounting. Managers get periodic updates about the state of affairs and are in a position to conduct an analysis of the same and improve their performance in the forthcoming periods.

DAY FOUR

Name _____ Date _____ Block _____

Read the article “History of Accounting” and answer the following questions.

Name and DESCRIBE the five (5) stages of accounting development.

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History of Accounting

One can never really understand a subject, unless they know where it came from. Therefore, a short history of the subject of accounting may be of interest to students of accounting. Here is a very brief history of how accounting evolved:

- **Single Entry Accounting System**

  Accounting is as old as financial transactions themselves. As soon as credit was invented, humans began to use accounting to simplify their lives. As expected, the oldest system of accounting used single entry accounting. This is the most intuitive form of accounting but is also incomplete. Records have been found on clay tablets in ancient Mesopotamia that show the existence of single entry accounting in that time.

- **Bahi-Khata System**

  Prior to rise of European commerce in the Medieval Ages, India was the primary center for bustling trade and commercial activity. Although there has been no record of this fact, but is claimed that Indian merchants had very advanced accounting systems at that time. These systems were called the Bahi Khata system. It is rumored that the westerners designed the double entry system based on the principles of Bahi Khata system but once again there is no conclusive proof.

- **Merchants of Venice**

  The birthplace of modern day accounting is Venice. In the Medieval Ages, Venice was a center of trade and commercial activity. Merchants had giant businesses and they were struggling to run these corporations efficiently. It is then that Luca Pacioli developed the double entry accounting system. There is still debate about whether he developed it or just improved it and made it available to the merchants. However, debate or no debate, Luca Pacioli is considered to be the “Father of Modern Day Accounting”.

- **Chartered Corporations**

  In the era of colonialism, chartered corporations were common. The government would approve certain companies and give them exclusive rights to trade with certain colonies. Citizens were encouraged to invest in such companies. Shares of a few such companies had paid rich dividends and hence it was common to invest in such companies.

  However, the performance of such companies had to be reported to the shareholders on a periodic basis. Therefore accounting systems were further developed. They were now providing information to external shareholders apart from providing information to internal management.

- **Modern Accounting**

  The chartered companies have long gone. The world is now a free market. But information still needs to be provided to the external shareholders about the conduct of operations. Accounting, therefore has been further developed and is highly regulated in most countries.

DAY FIVE

Name _____ Date _____ Block _____

Read the article “Need for a Theory of Accounting” and answer the following questions.

1. What is meant by “creative accounting?”

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2. What is the issue at the root of the crisis?

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3. Describe descriptive theories

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4. Describe normative theories

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5. Why do researchers shift from theory to theory?

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Need for a Theory of Accounting to Improve the Accounting Profession

Creative Accounting and the Need for a Theory of Accounting

The rise of "**creative accounting**" practices, an euphemism for hiding some unfavorable financial details and highlighting favorable ones to create an impression of sound financial health has resulted in the accounting profession taking more hits to its credibility.

It is a well known fact that the recent economic crisis witnessed firms that hid some of their liabilities "off the books" or "off-balance sheet" items, the way in which the accounting profession functions has come under renewed scrutiny by the regulators. The lack of theory in accounting has indeed been a bane for the profession as can be seen from the "fragmented" nature of the profession in different countries and within the same country as well in some cases.

This has led to a situation where the professional bodies of accountants had to step in frequently to adjudicate on matters of the reliability of a particular theory over the other.

Just as the medical profession had to engage in expensive and long drawn battles in the courts over the methods employed by them, the accountants too found themselves arguing about the correctness of their methods.

The issue at the root of this crisis is the lack of a unified theory and the fractious nature of the interpretation that accountants often do when confronted with an accounting problem.

Theories of Accounting

If we examine the theories of accounting that have developed over the course of the 20th century, we find that the period was characterized by the adoption of descriptive, normative and positive theories that underpinned the conceptual framework for accounting.

The descriptive theories represented the first serious attempt to codify the body of knowledge prevalent in accounting norms by recourse to description of the accounting practices rather than prescribing what ought to be done or predicting and explaining what needs to be done. The descriptive theories of accounting developed in the 1920's and were in vogue till the 1960's when researchers took a fancy to the normative or prescriptive theories of accounting.

The normative theories of accounting developed in the period of the 1960's and 1970's and did not assume that what is being done by the majority was right as was the case with the descriptive theories. The normative theories arose to satisfy the post World War Two boom in corporate capitalism and hence were the product of an era that emphasized deductive arguments based on estimating future growth and prescribing a set of actions that the firms could undertake with regards to increasing their revenues.

Hence, **the development of the normative accounting theories was characterized by a focus on estimation rather than observation** that fit in nicely with the prevalent worldview of those

decades where growth was the mantra and firms needed to make decisions as to the usefulness of a particular course of action from the financial perspective.

The return of positive theories that emphasized rationality and the reliance on sophisticated tools that tested the predictions versus the results meant that researchers and the accountants could again take recourse to the “rational” means of accounting.

Why Do Researchers Shift from Theory to Theory ?

There can be many reasons why researchers shift from one theory to the other. They can range from the researchers having different perspectives of the role of theory in practice to the researchers own values and biases influencing their choice of theory and the fact that they might try to denigrate their rivals with the superiority of their theories.

If we examine each of these reasons in detail, we find that the way in which the researchers have chosen to embrace this theory or the other, like for instance, the adoption of positive theories and then the normative theories and a return to positive theories represent what Thomas Kuhn has referred to as “paradigm shifts” that happen in discrete jumps when one theory is replaced by the another in response to sufficient evidence backing the new theory.

Similarly, the researchers in the accounting profession have responded to the changing needs placed on them by businesses and the demands of the times that they were in and hence different theories have arisen as a result.

If the early decades of the 20th century witnessed the adoption of descriptive theories that went with the consensus view only to be replaced in the “boomer” years with theories that attempted to map the future and then a “return” to the positive theories that test the hypotheses against actual results as a way to predict and explain the accounting methods.

Hence, we can discern a cyclical shift from induction to deduction to a combination of both with emphasis on testing the results against the predictions.

It is our opinion that the accounting profession has responded to the changes in regulatory requirements as well as advances in technology in the way they chose particular methods over the others.

The overriding feeling that one gets by examining the readings is that a unified approach to the methods and techniques of the profession would do good for the accountants as well as the business community in general.

Impact on Corporate and Economic Crises

As mentioned in the preceding sections, the accounting profession has been rocked by a series of scandals from the beginning of the modern accounting practice. For instance, the Great Depression of the 1930’s impacted the accounting profession by highlighting the lack of theory and regulation of the profession.

Among the many factors that are thought to have been responsible for the Great Depression are the ones related to the role of ethics in accounting practices, the echo of which we find repeating in the current economic crisis. Now as then, there are calls for increased regulation and oversight by organizations like the SEC (Securities and Exchange Commission) as well as a need for transparency by the accountants themselves. It is ironic that the accountants are being called to be accountable which is akin to “who will mandate the lawmakers” analogy.

Conclusion

It is clear from the above discussion that it is high time for the accounting professionals of the world to arrive at a consensual approach towards the practice, if not the theory, of accounting.

Though this statement might seem contradictory as the practice follows the theory, a nuanced reading of it would reveal that the issues of “interpretation” and “perception” have dogged the accounting profession.

Hence, it is hoped that the adoption of accounting theories that validate their predictions with actual results would lead to a more coherent approach to the accounting methods in vogue.

Before concluding the article, it would be pertinent to remember the damage that the Enron scandal caused the accounting profession and the resultant erosion of trust in the profession. In conclusion, I tend to agree with the assertion by Sterling about the need for theory in accounting and the harm the lack of such theory has done to the profession.