

# [Accounting one theory in accounting. "people only](https://assignbuster.com/accounting-one-theory-in-accounting-people-only/)

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Accounting can be consideredto have many roles in society, it can be a form of communication acrossdifferent arenas. Society is essentially made up of various arenas whichconsist of: organisational society, political concept and economics.

Communication across thesearenas are via financial language within financial statements, essentiallyhelping users with decision making. In this essay I will evaluatethe following statement ‘ Communicating reality in accounting is easy – wesimply record what we see’. There are various theories andimages set out that help underpin accounting. In other words, the theories areset out to understand what accounting is all about and how it should functionin an ideal world. Financial statements have been socially constructed, meaningthat they have been constructed for people by people, which is an example ofone theory in accounting. “ People only think of you ascommunicating reality, but in communicating reality, you construct reality”(Hines, 1988: p.

257). Accounting researchers like Hines has challenged the viewof external realism. He argues for a socially constructed accountingpresentation, suggesting that accountants do not illustrate reality, but infact construct reality.

Solomons (1991) suggests thataccountants should go out and look at journalists, follow their rules andessentially report the news as they see it. “ I believe that accountants arelike journalists. They should report the news, not make it” (Solomons, 1991: p. 287).

However, Tinker (1991) disagreed with Solomons’ theory and suggestedaccountants may misrepresent reality like journalists can. Tinker also statedthat “ David Solomons does not say that journalists actually “ do” report thenews, only that “ they should”” (Tinker, 1991: p. 300). I think Tinker is tryingto convey a message by saying that Solomons’ use of words means that evenjournalists do not report the news as they see it. I understand the implicationsof an accountant going out and doing what a journalist does, effectively ‘ reportingthe news as they see it’.

However, I personally feel that many journalistsmisrepresent reality and with accountants going out and being like them, thiscan influence a misrepresentation of reality too. This can be further provenwhen Tinker used the example of the director of Israel Broadcasting, failing tocomply with the journalist’s code of practice. (Tinker, 1991: p. 300) In otherwords, if journalists can fail to comply with the rules and regulations set outfor them, what makes it so sure that accountants would not do so too? Solomons (1991) then went onto say that accountants should function like cartography in producing maps ofeconomic reality.

Again, Tinker disagreed with Solomons’ theory stating that “ mapsdo not represent facts as there are misrepresentations that affect ourbehaviour” (Tinker, 1991: p. 300). It was then further suggestedby Solomons (1991) that accountants should function like a speedometer incapturing the real economic speed of an entity. However, Tinker (1991) argued thatdrivers would then be tempted to tamper with speedometer readings to avoiddetection and prosecution, and thus would be a subject to the same” incentives-to-cheat as managers who produce financial reports”. (Tinker, 1991: p.

299). I personally agree with Tinker(1991) as the idea of drivers being able to tamper the speedometer to avoiddetection can ultimately result in accountants doing the same to the financialstatements. In addition, Solomons (1991)offers the idea of accountants conveying their messages through telephonecommunications to a group of users or an audience. He also stresses that thetask of accountants is to provide information which is free from bias. On the other hand, Tinker (1991)further disagreed with his theory, stating that “ Thoughts and words may be madeto differ intentionally or otherwise. There is no guarantee that they willconform to “ what is understood” and that the telephone is selective, andinevitable reflects intended and unintended bias” (Tinker, 1991: p. 299).

However, as demonstrated bySolomon (1991) and Tinker (1991) no specific image/theory fully captures whataccounting is all about. In my opinion I think that the different theoriesprovide different angles on seeing things, and possibly implementing thesetheories could possibly throw some light onto accounting and make sense of it. It is also evident that suchdebates between researchers taking place represent the problematic nature ofaccounting and the possible loopholes in its development. A conceptual framework was putforward to set out the theoretical ideas which underpin accounting. This ideastarted in the late 60’s early 70’s by understanding the accounting purposes. (Deegenand Unerman, 2011).

The conceptual framework isderived from accounting concepts and can be described as a ‘ boundary’ withcomponents such as IFRS, true and fair view, SSAP2 and case law. However, thereare ‘ grey’ areas which are issues undetected in accounting. Accounting had no structure inany kind of theoretical framework, unlike professions such as doctors andteachers. These professions had theoretical knowledge backing them up such asscience in the case of a doctor and technology in the case of a teacher. Accounting originally had no knowledge base but essentially evolved over time. A conceptual framework can bedescribed as “ a coherent system of interrelated objectives and fundamentalsthat is expected to lead to consistent standards” (Deegen and Unerman, 2011: p. 206).

Ultimately a conceptualframework is an attempt to identify what accounting is about, who is it for, what are the objectives and what makes information reliable. A conceptualframework might give us information about these ideas. It gives us variousdefinitions of items such as assets and liabilities and an understanding ofwhat we do in accounting.

However, it may also be viewed as unhelpful as it istime consuming and costly. It has been argued that thereare various benefits relating to having a conceptual framework in place. “ Providingthe foundation that can provide the guidance for standard setting, allowing thestandard-setting body to utilize economics in their efforts to developstandards and providing broad prescriptive concepts to allow other concepts toflow from them” (Belkaoui, 2004: p. 202). I believe that having aconceptual framework in place is a step in the right direction as it provides a’foundation’ for a knowledge and theoretical base essentially reducing someloop-holes.

These loop-holes could be the basic definitions of items such as assetsand liabilities. However, with that said, I also believe there are still manyloop-holes within the conceptual framework. The conceptual framework is not astandard, therefore will accountants comply with it? The framework lacks inconsistency and I believe there is room for interpretation as well as opinion.

For example, little attention is given to the concept of the true and fairview, which is essentially a fundamental loop-hole. Accounting only had SSAP2, the’Disclosure of Accounting Principles’ to depend on before the development ofthe conceptual framework. “ Developed in 1971 SSAP2 hashistorically played an integral role in accounting in the absence of otherstandards” (Barden, 2000: p. 80). SSAP2 considered consistency, accruals, prudence and going concern as the fundamental concepts in accounting. These accounting concepts are argued to construct reality. Being consistent in accountingis essential, in relation to accounting a company may have to show consistencywhen calculating depreciation.

For example, if a company uses straight linedepreciation to depreciate their assets, they should be consistent and use thesame method throughout. The going concern concept isthe assumption that an entity will remain in business for the foreseeablefuture. SSAP2 was beneficial toaccounting however there were a few problems.

Prudence required judgement andopinion, which conflicts with neutrality. Going concern required thataccountants make fundamental assumptions about the future of a business, whichessentially contradicts prudence (Barden, 2000). FRED21 turned into FRS18’Accounting Policies’ in December 2000. The statement of principles 1991, madeit essential that SSAP2 was reviewed. FRS18 states the importance onaccruals and going concern concepts.

However, prudence and consistency are oflower importance. FRS18 singling out the two concepts of accruals and goingconcern in my opinion is a good thing. This is because the going concern isextremely important to generally accepted accounting principles (GAAP). Without the going concernconcept, businesses would not have the ability to prepay or accrue expenses. Ifthe public did not assume that a given company would stay in business and keepoperating, why would they prepay or accrue anything towards that business? Ithink it also plays a huge role in assets, as the entire concept ofdepreciating as well as amortizing assets is essentially based on the givenidea that the business will continue to operate. FRS18 disregards theimportance of attempting to define the true and fair view, which essentiallyrelies on the user’s knowledge of what true and fair view means. FRS18 then further state thatcomparability and relevance are of greater importance as it has been driven bythe need for users to be provided with relevant information, which is easilycomparable.

These can be referred to as the qualitative characteristics. If we take these definitionsapart, the terms prove to be socially constructed as well as subjective. Information should be relevantto the decision-making needs of the user. This information is consideredrelevant if it helps the users of the financial statements in predicting future’trends’ of the business.

In relation to comparability, it is essential that financial statements of one accounting period iscomparable to another for the users to come to meaningful conclusions about thetrends in a business. All these theories, conceptsand standards that are in place is an attempt to put forward knowledge. Thereare also sources of knowledge known as: perception, reasoning, introspection, memory, faith, intuition and lastly, testimony. Perception is the process ofgathering knowledge through our five senses, therefore this can be related tothe process of induction under observations.

The process of induction isknown as the process of gathering knowledge. This cycle consists of observations, laws and theories, and finally prediction. This is the development of ideas ortheories through observations. “ Theories are developed bydeductive reasoning, which is based more upon the use of logic rather thanobservation” (Deegen and Unerman, 2011: p.

6). However, there are somedisadvantages to the process of induction. I personally think that the processof induction assumes that someone knows what they are asked to observe. Forexample, if someone was told to go out and collect data of how many red carsthere are, you are assuming that they know what a car is, and they know whatthe colour red is.

Ultimately this means thatobservations can be flawed. Once observations have been collected, you come upwith a law and a theory and implement it which then results in a prediction ofwhat the future can be like. Karl Popper suggests thatprecise theories can be proven false through observations.

For example, ifsomeone says, ‘ all tigers are orange’ and then someone finds a white tiger thenthat theory has been proven wrong through observation. True and fair view might formthe foundation of this framework. However, we may not ever fully understandwhat a true and fair view is. If we break down the words, wecan have a better understanding of what the true and fair view means.

The truthdoes not change, only our knowledge of it does. True and fair view can be basedon the knowledge of the user and theories can possibly help us gain thisknowledge.” The Companies Act 2006requires that the directors of a company must not approve accounts unless theyare satisfied that they give a true and fair view” (ACCA, 2014). There is always the concept ofusers vs.

preparers and it is important to try and understand the requirementsand expectations of both parties. Financial statements have been sociallyconstructed to present a true and fair position of the company. Solomons (1991) has arguedthat financial information should be neutral, in other words free from biastherefore meeting the definition of true and fair. Users would want accounts tobe signed off for reliance and assurance, however the preparers would not wantto do this as if any errors were to arise, the person who signed them off couldpossibly be sued for providing a false representation of true and fairdocuments. An example of this could bethe Tesco scandal which occurred in 2014.

The company had overstated theirprofits and presented their accounts having signed them off as a ‘ true and fairrepresentation’ of the company. However, the error was found, and it was evident that it was not given the correct attention to be correctedand therefore Tesco were penalised for not complying with the rules andregulations.  In conclusion I think thatcommunicating reality is a lot more complex than one would think. This is dueto the many requirements of the public such as the ‘ true and fair view’ andessentially the need to have a knowledge base. It is important that accountantshave an in-depth understanding of what their profession is, and the process ofgathering that knowledge is very long winded.

Furthermore, communicating thatreality may consist of biased information and finding a way to communicate thatreality is often hard as there are many theories of what should be done.