

Accounting research: advantages of cash flow essay sample

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* Cash flow is more “ direct” as “ profit” is highly dependent on accounting conventions and concepts/principles * Cash flow reporting satisfies the needs of all users better since cash flow is more direct with its messages. Some of the interested user parties are: * Creditors -repayment of debts, overdue accounts

* Management -cash flow reporting provides the type of information which decision should be taken re: relevant costs (decision based on future cash flow) * Shareholders & Auditors -cash flow accounting and reporting can provide a satisfactory basis for stewardship accounting * Workers/staff needs to know that they are able to be paid for their wages & salaries and the enterprise they are working are stable * Cash flow forecasts are easier to prepare plus more useful than profit forecasts * Cash flow accounting in certain respects can be audited more easily than accounts based on the accruals or matching concept * Accruals concept is more confusing whereas cash flows are more easily understood * Cash flow with future projections or forecast are of great information value to all users of accounting information. [should include variance analysis of the forecast by monitoring against actual cash flow.

Disadvantages of Cash flow

* Lack of Tracking- Payments to the business is recorded as they come in, as are payments out of the business. The dates and times of these transactions are not recorded, however, making it very difficult to track down specific payments if errors are suspected. Likewise, the lack of tracking makes it impossible to connect specific payments with items of inventory or services that are rendered by contractors or other third parties. Being unable to track

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these payments can be a major disadvantage if accounting errors occur. *

Offset Payment Problems- Cash flow accounting lacks dedicated departments for accounts receivable and accounts payable, making it difficult to keep track of money owed to the business as well as money that the business owes. This becomes a larger concern when shipments and deliveries are billed separately from the actual delivery of goods or when the business performs services but does not receive immediate payment; unpaid debts and payments due can become lost or delayed, resulting in problems between the business and its suppliers or customers. *

Lack of Oversight- Because cash flow accounting doesn't track the flow of money within a business, accounting errors can go unnoticed until they cause cash flow problems.

Without the oversight provided by in-depth accounting and the separation of accounts payable and accounts receivable, financial reports can be produced which contain significant errors that simply haven't been noticed within the fluctuations of cash flow. This can result in financial reports and projections that are inaccurate or in some cases are significantly overstated. *

Partial Payment Recording- When partial payments are made or received they aren't recorded as being only part of a larger payment. At first glance, a partial payment may appear as a full payment on a balance sheet and lead business managers to think that all money due to the business or all money owed has been paid. This can result in accounting errors and the unintentional underpayment of debts.

Confusion can also arise if multiple partial payments are mistaken for full payments, leading to unnecessary audits and wasted time trying to find the source of the error. * Profitability Errors- Cash flow accounting does not accurately reflect the expenses required to generate income, making it difficult to determine how profitable a business actually is. Large purchases that may assist in operating the business for months or years will be matched only with the income of the period in which the purchase was made, making that period seem significantly less profitable. Likewise, significant expenses required to make money might not be associated with the period of higher income they generate if the income occurs within a different accounting period.

Social and Ethical Issues of Financial Reporting

Socially: Financial Reporting must be correct so that the shareholders can profit the most from the information and the distribution of goods to the public can be maximized. Ethically: Financial Reporting must be correct so that you can live with yourself...if you do not report correct information you can go live with some really bad people that drop their soap in the shower to see if you pick it up for them.

Impact of inflation on assets in financial statements prepared under historical basis

Under this type of accounting, assets and liabilities are recorded at their values when first acquired. They are not then generally restated for changes

in values. Costs recorded in the Income Statement are based on the historical cost of items sold or used, rather than their replacement costs.

Limitations of financial statements

Financial statements are based on historical costs and as such the impact of price level changes is completely ignored. They are interim reports. The basic nature of financial statements is historic. These statements are neither complete nor exact. They reflect only monetary transactions of a business.

The following limitations may be noted: 1. the financial position of a business concern is affected by several factors-economic, social and financial, but financial factors are being recorded in these financial statements. Economic and social factors are left out. Thus the financial position disclosed by these statements is not correct and accurate. 2. The profit revealed by the Profit and Loss Account and the financial position disclosed by the Balance Sheet cannot be exact. They are essentially interim reports. 3. Facts which have not been recorded in the financial books are not depicted in the financial statement. Only quantitative factors are taken into account. But qualitative factors such as reputation and prestige of the business with the public, the efficiency and loyalty of its employees, integrity of management etc. do not appear in the financial statement.

4. The rupee of 1995, as for example, does not mean the same as the rupee of 2010. The existing historical accounting is based on the assumption that the value of monetary unit, say rupee, remains constant and accordingly assets are recorded by the business at the price at which they are required and the liabilities are recorded at the amounts at which they are contracted

for. But monetary unit is never stable under inflationary condition. This instability has resulted in a number of distortions in the financial statements and is the most serious limitation of historical accounting. 5. Many items are left to the personal judgment of the accountant.

For example; provision of depreciation, stock valuation, bad debts provision etc. depend on the personal judgment of accountant. 6. On account of convention of conservatism the income statement may not disclose true income of the business since probable losses are considered while probable incomes are ignored. 7. The fixed assets are shown at cost less depreciation on the basis of “going concern concept” (one of the accounting concept). But the value placed on the fixed assets may not be the same which may be realized on their sale. 8. The data contained in the financial statements are dumb; they do not speak themselves. The human judgment is always involved in the interpretation of statement. It is the analyst or user who provides tongue to those data and makes them to speak. Current Cost Accounting

Current cost accounting attempts to provide more realistic book values by valuing assets at current replacement cost, rather than the amount actually paid for them. This contrasts with the usual historical cost approach. The current cost is usually calculated by adjusting the historical cost for inflation, in addition to the usual adjustments such as depreciation. Current cost accounting is more complex than historical cost accounting, and attempts to implement it tend to create controversy over what adjustments are appropriate. This has some interesting comments on the reasons for the

failure of attempts at inflation accounting. The problems that current cost accounting (and other approaches to accounting for inflation) attempt to solve are obviously linked to inflation. Interest in inflation accounting tends to be greatest when inflation is high and low when inflation is low.

Fair Value Accounting

Fair value is the value of an asset or liability in an arm's length transaction between unrelated willing and knowledgeable parties. The concept of fair value is used in many accounting standards including the IFRS covering acquisitions, and the valuation of securities, but is not limited to these. Fair value accounting requires assets to be revalued when the fair value is materially different from the current book value. Assets may need to be revalue (such as when the market value of securities changes), or their purchase price may not be separable from a larger transaction (as happens in an acquisition). Increases in the value of an asset are added to the revaluation reserve. Some methods of determining fair value are preferred to others as they are more accurate when they can be used. The methods used are, in IFRS order of preference: * If there are identical transactions in the market, assets and liabilities should be valued with reference to such transactions — i. e. marked to market. * If identical transactions do not exist, but similar transactions exist, fair value should be estimated making the necessary adjustments and using market based assumptions * If either of the above methods cannot be used, other valuation methods may be used — this is what allows marking to model. Fair value often has a subjective element as so many valuations are likely to use the latter two methods. Fair value of intangible assets

The value of intangible assets, especially goodwill has a significant effect on reported profits and balance sheets. The common exclusion of goodwill for valuation purposes makes this less important for investors. After the initial recognition of goodwill, it should be tested for impairment annually. The methods used for valuing intangible assets are categorised (by an IFRS) into market methods (the first two above) and the income method (the third of the above). Fair value of securities

IFRSs require use of the following methods, in order of preference: * Quoted market prices should be used if available.

* The price should be estimated using market data and with reference to the current market value of a similar instrument. * Where the above methods cannot be used, a company should use cost less impairment