

# [Financial accounting theories: questions and answers](https://assignbuster.com/financial-accounting-theories-questions-and-answers/)

In the nature of theory, a positive theory of accounting or Positive Accounting Theory is a descriptive theory, which describes particular aspects of financial accounting practice. It seeks to predict, observe, and explain which accounting methods accountants will or will not use in particular circumstances and why managers and/or accountants elect to adopt particular accounting methods in preference to others. While a normative theory of accounting is a prescriptive theory, which prescribes how accounting should be undertaken. It generates guidance about what accountants should do. It seeks to tell accountants which accounting method in practice is the most efficient or equitable process and hence, which accounting method accountants should use.

In the concept of theory, a positive theory of accounting is developed through inductive reasoning that is, through observations. The theory developed is based on observing ‘ what accountants do’. While a normative theory of accounting is developed through deductive reasoning that is, logical reasoning. The theory developed is based more on the use of logic that is, ‘ what accountants should do’ rather than observation.

### If a normative theory of financial accounting has been developed to prescribe how we should do financial accounting, is it possible that we can decide to reject the theory because we do not with agree with a central assumption of the theory (such as an assumption about the objective of financial reporting), but at the same time decide that the theory is nevertheless logical? Explain your answer.

Yes, we can reject a theory even that the theory is logical. For instance, the capital markets that we use as an assumption are efficient. Besides that, individuals are motivated by self-interest bind together with the wealth maximization. It might lead us to make particular prescriptions about what information organizations should produce. Self-interest means a core belief about what motivates individual action. However, we might consider that the prescriptions provided by the theory are unsound and potentially even negative impact to particular groups within society if we reject these assumptions. In short, we might even to believe that the theory is logically developed.

### Is the study of financial accounting theory a waste of time for accounting students? Explain your answer.

In my opinion, the study of financial accounting theory is not a waste of time for accounting students. In fact, it is important for accounting students to study and understand financial accounting theories. This is because; accounting theories aim to provide a coherent and systematic framework for investigating, understanding and/or developing various accounting practices. The evaluation of individual accounting practices is likely to be much more effective if the person evaluating these practices has a thorough grasp of accounting theory. Without a thorough theoretically informed understanding of accounting, it is difficult to evaluate the suitability of current accounting practices, to develop improved accounting practices where current practices are unsuitable for rapidly changing business situations, and to defend the reputation of accounting where accounting practices are wrongly blamed for causing companies to fail. Hence, the insights from a varied range of accounting theories are essential to the process of continual improvement in financial accounting practices.

In addition, students of financial accounting will also be required to learn how to construct and read financial statements prepared in conformity with various accounting standards and other professional and statutory requirements. In their working life, whether or not they choose to specialize in accounting, they could be involved in such activities as analyzing financial statements for the purpose of making particular decisions, compiling financial statements for others to read, or generating accounting guidance or rules for others to follow. As such, the better they understand the accounting practices underlying these various activities, the more effective they are likely to be in performing these activities – and therefore, the better equipped they are likely to be to succeed in their chosen career.

### Explain the meaning of the following paragraph and evaluate the logic of the perspective described:

In generating theories of accounting that are based upon what accountants actually do, it is assumed (often implicitly) that what is done by the majority of accountants is the most appropriate practice. In adopting such a perspective there is, in a sense, a perspective of accounting Darwinism – a view that accounting practice has evolved, and the fittest, or perhaps “ best”, practices have survived. Prescriptions or advice are provided to others on the basis of what most accountants do, the logic being that the majority of accountants must be doing the most appropriate thing.

From approximately the 1920s to the 1960s, theories of accounting were normally developed on the basis of observation of what accountants actually did in practice. They were developed by the process referred to as sense. This can be contrasted with a process wherein theories are developed by deductive reasoning which is based more upon the use of logic rather than observation. Besides, returning to the use of observation to develop generalisable theories is based on the common practices which were codified in the form of conventions of accounting after observing what accountants did in practice.

These approaches of the theories were adopted by Notable theories, which careful observation of accounting practice revealed patterns of consistent behaviour. For example, it could be observed that accountants tended to be very prudent in measuring both revenues and expenses. Where judgement was necessary it was observed that accountants usually underestimated revenues and overstated expenses. The result was a conservative measure of profit.

Similarly, it could be observed that accountants behaved as if the value of money, which was the unit of account, remained constant. These observations of accounting practice led to the formulation of a number of hypotheses such as ‘ that where judgement is needed, a conservative procedure is adopted’ and ‘ that it is assumed that the value of money remains constant’. These hypotheses were confirmed by many observations of the behaviour of accountants.

While there was a general shift towards prescriptive research in the 1960s, some research of an inductive nature still occurs. Research based on the inductive approach has been subject to many criticisms. For example, Gray, Owen and Maunders (1987, p. 66) state that studying extant practice is a study of ‘ what is’ and, by definition does not study ‘ what is not’ or ‘ what should be’. It therefore concentrates on the status quo, is reactionary in attitude, and cannot provide a basis upon which current practice may be evaluated or from which future improvements may be deduced.

### What role do values judgments have in determining what particular accounting theory a researcher might elect to adopt to explain or predict particular accounting phenomena?

Value judgements have a major power to make with what theory a researcher might elect to use to explain or predict particular phenomena. These indicate that, we must consider the particular accounting theory researchers might use to explain the companies elect to produce information about their social and environmental performance. In case, I believed that company managers are motivated by self-interest. At that time, I would embrace a Positive Accounting Theory. A Positive Accounting Theory has self-interest as one of the fundamental assumptions about what drives human behaviour. These people would have a trend towards believing that all human activity. The activities include the disclosure of social and environmental information. This means that, it is undertaken to the limits that the activity can be related back to positively impacting the managers’ wealth.

Besides, it typically requires people of current generations to offer current consumption to extent it is in the interests of future generations if I was a researcher who holds a vision of sustainable development. In this way, I would reject Positive Accounting Theory as self-interest and sustainable development are to mutually exclusive. For example, researcher would embrace another theoretical perspective such as legitimacy theory. However, there are no researchers in the area of social and environmental accounting enfolds Positive Accounting Theory although it is interesting to note that.