Astudy on Types and Users of Accounting

ANJANABEN J. TRIVEDI
Ph.D. Scholer,
Dept. of Commerce, Gujarat Uni. Ahmedabad

AMIT MEHTA
Research Guide,
Dept. of Commerce, Gujarat Uni. Ahmedabad

1. Types of Accounting

Accounting is a vast and dynamic profession and is constantly adapting itself to the specific and varying needs of its users. Over the past few decades, accountancy has branched out into different types of accounting to cater for the diversity of needs of its users.

1.1 Financial Accounting

Financial Accounting, or financial reporting, is the process of producing information for external use usually in the form of financial statements. Financial Statements reflect an entity's past performance and current position based on a set of standards and guidelines known as GAAP (Generally Accepted Accounting Principles). GAAP refers to the standard framework of guideline for financial accounting used in any given jurisdiction. This generally includes accounting standards (e.g. International Financial Reporting Standards), accounting conventions, and rules and regulations that accountants must follow in the preparation of the financial statements.

1.2 Management Accounting

Management Accounting produces information primarily for internal use by the company's management. The information produced is generally more detailed than that produced for external use to enable effective organization control and the fulfillment of the strategic aims and objectives of the entity. Information may be in the form budgets and forecasts, enabling an enterprise to plan effectively for its future or may include an assessment based on its past performance and results. The form and content of any report produced in the process is purely upon management's discretion.

Cost accounting is a branch of management accounting and involves the application of various techniques to monitor and control costs. Its application is more suited to manufacturing concerns.

1.3 Governmental Accounting

Governmental Accounting, also known as public accounting or federal accounting, refers to the type of accounting information system used in the public sector. This is a slight deviation from the financial accounting system used in the private sector. The need to have a separate accounting system for the public sector arises because of the different aims and objectives of the state owned and privately owned institutions. Governmental accounting ensures the financial position and performance of the public sector institutions are set in budgetary context since financial constraints are often a major concern of many governments. Separate rules are followed in many jurisdictions to account for the transactions and events of public entities.

1.4 Tax Accounting

Tax Accounting refers to accounting for the tax related matters. It is governed by the tax rules prescribed by the tax laws of a jurisdiction. Often these rules are different from the rules that govern the preparation of financial statements for public use (i.e. GAAP). Tax accountants therefore adjust the financial statements prepared under financial accounting principles to account for the differences with rules prescribed by the tax laws. Information is then used by tax professionals to estimate tax liability of a company and for tax planning purposes.

1.5 Forensic Accounting

Forensic Accounting is the use of accounting, auditing and investigative techniques in cases of litigation or disputes. Forensic accountants act as expert witnesses in courts of law in civil and criminal disputes that require an assessment of the financial effects of a loss or the detection of a financial fraud. Common litigations where forensic accountants are hired include insurance claims, personal injury claims, suspected fraud and claims of professional negligence in a financial matter (e.g. business valuation).

1.6 Project Accounting

Project Accounting refers to the use of accounting system to track the financial progress of a project through frequent financial reports. Project accounting is a vital component of project management. It is a specialized branch of management accounting with a prime focus on ensuring the financial success of company projects such as the launch of a new product. Project accounting can be a source of competitive advantage for project-oriented businesses such as construction firms.

1.7 Social Accounting

Social Accounting, also known as Corporate Social Responsibility Reporting and Sustainability Accounting, refers to the process of reporting implications of an organization's activities on its ecological and social environment. Social Accounting is primarily reported in the form of Environmental Reports accompanying the annual reports of companies. Social Accounting is still in the early stages of development and is considered to be a response to the growing environmental consciousness amongst the public at large.

2. Users of Accounting

Role of accounting is not just limited to the information needs of employees and investors of a business. Accounting nowadays fulfills the information needs for a diverse group of stakeholders each with its own information requirement as discussed in the article: users of accounting information. Users of accounting are both internal and external to the organization.

2.1 Internal Users of Accounting

Internal users are the primary users of accounting.
Following are the 3 types of internal users and their information needs:

2.1.2 Owners

Owners need to assess how well their business is performing.
Financial statements provide information to owners about the **profitability** of the overall business as well as individual products and geographic segments.

Owners are also interested in knowing how risky their business is.
Accounting information helps owners in assessing the level of stability in business over the years and to what extent have changes in economic factors affected the bottom line of the business. Such information helps owners to decide if they should invest any further in the business or if they should use their financial resources elsewhere in more promising business ventures.

2.1.3 Managers

Managers need accounting information to plan, monitor and make business decisions. Managers need to allocate the financial, human and capital resources towards competing needs of the business through the budgeting process.

Preparing and monitoring budgets effectively requires reliable accounting data relating to the various activities, processes, products, services, segments and departments of the business.

Management requires accounting information to monitor the performance of business by comparison against past performance, competitor analysis, key performance indicators and industry benchmarks.
Managers rely on accounting data to form their business decisions such as investment, financing and pricing decisions. In case of investment decisions for example, managers would require the return on investment calculation of a proposed project supported by reliable estimates of the costs and revenues.

2.1.4 Employees

For the employees operating in the finance department, using accounting information is usually part of their job description. This includes for example preparing and reviewing various financial reports such as financial statements. Employees are interested in knowing how well a company is performing as it could have implications for their job security and income. Many employees review accounting information in the annual report just to get a better understanding of the company's business.

In recent years, the increase in number of shares and share options schemes for employees particularly in startups has fostered a greater level of interest in accounting information by employees. Moreover, potential employees are also interested to learn about the financial health of the organization they aspire to join in the future.

2.2 External Users of Accounting

External users are the secondary users of accounting.
Following are the 8 types of external users and their information needs:

2.2.1 Investors

Investors need to know how well their investment is performing. Investors primarily rely on the financial statements published by companies to assess the profitability, valuation and risk of their investment. Investors use accounting information to determine whether an investment is a good fit for their portfolio and whether they should hold, increase or decrease their investment.

2.2.2 Lenders

- Lenders use accounting information of borrowers to assess their credit worthiness, i.e. their ability to pay back any loan.
- Lenders offer loans and other credit facilities on terms that are based on the assessment of financial health of borrowers.
- Good financial health is indicated by the borrower's ability to pay its liabilities on time, high profitability, substantial securable assets and liquidity.
- Poor liquidity, low profitability, lack of assets that can be secured and an inability to pay liabilities on time demonstrate poor financial health of borrowers.
- On a lighter note, borrowers can only get a loan from lenders if they can prove that they don't need the money.

2.2.3 Suppliers

Just like lenders, suppliers need accounting information to assess the credit-worthiness of its customers before offering goods and services on credit. Some suppliers only have a handful of customers. These customers could be very large businesses themselves. Suppliers need accounting information of its key customers to assess whether their business is in good health which is necessary for sustainable business growth.

2.2.4 Customers

Most consumers don't care about the financial information of its suppliers. Industrial consumers however need accounting information about its suppliers in order to assess whether they have the required resources that are necessary for a steady supply of goods or services in the future. Continuity in supply of quality inputs is essential for any business.

2.2.5 Tax Authorities

Tax authorities determine whether a business declared the correct amount of tax in its tax returns. Occasionally, tax authorities conduct audits of the tax returns filed by businesses in order to verify the information with the underlying accounting records. Tax authorities also cross reference accounting information of suppliers and consumers in order to identify potential tax evaders.

2.2.6 Government

Government ensures that a company's disclosure of accounting information is in accordance with the regulations that are in place to protect the interest of various stakeholders who rely on such information in forming their decisions. Government defines and monitors accounting thresholds such as sales revenue and net profit to determine the size of each business for the purpose of ensuring that it complies with the relevant employee, consumer and safety regulations.

2.2.7 Auditors

External auditors examine the financial statements and the underlying accounting record of businesses in order to form an audit opinion. Investors and other stakeholders rely on the independent opinion of external auditors on the accuracy of financial statements.

2.2.8 Public

General public may also be interested in accounting information of a company. These could include journalists, analysts, academics, activists and individuals with an interest in economic developments.

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