

Challenges Faced by Financial Accounting and Suggested Solutions

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Abstract

Benefiting from economic globalization, China has stepped up its economy, which is especially shown by the continuous development of internet technology in the 20 century. The trend of informatization has seeped into every aspect of life, including financial accounting. It has broken the limitation of traditional accounting, bringing financial accounting new opportunities and challenges. This paper analyzes the situation of financial accounting in China, explains the challenges from economic environment, production and business operation, organizational structures, and information processing and transferring, and provided suggested solutions accordingly.

Key words: Financial accounting; Informatization; Corporate management; Challenges

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INTRODUCTION

Financial accounting is an important branch of accounting that developed on the basis of traditional accounting and regulated by generally accepted accounting principles. Its primary purpose is to prepare general purpose financial statements for the external stakeholders. On the one hand, the 20th century has witnessed financial accounting's tremendous progress in terms of information system,

measuring techniques, and financial reporting system. Accounting, including financial accounting, on the other hand, develops simultaneously with the economy. China's rapid economic development and improvement of capital market has ushered in the age of information and finance, which in turn brought about drastic changes in financial accounting environment and many challenges. To deal with these challenges, authoritative accounting organizations have devoted to great efforts and resources. Nevertheless, many problems are still unsolved due to their complexity. This paper offers a comprehensive analysis of the challenges faced by financial accounting and accordingly provides some suggestions.

1. SITUATION OF FINANCIAL ACCOUNTING IN CHINA

1.1 Definition of Financial Accounting

Financial accounting is an essential part of modern corporations. By applying a series of financial procedures, it provides useful information for decision making. It especially plays an active role in company's operation and management decisions, which not only enhances the economical performance in the firm but also benefits the ordered development of market economy. Financial accounting, in the end, is an economic management activity that comprehensively and systematically records, summarizes, and monitors past financial transactions from a business, mainly aiming at providing external stakeholders—investors, creditors, government authorities—with information that encapsulates the firm's financial positions, profitability, and so on.

1.2 Components of Financial Accounting

1.2.1 Accounting Principles

Accounting principles set up standards for the quality of financial accounting information, which are objectivity,

relevance, comparability, consistency, timeliness, clarity, etc. Financial accounting information, as a public good, should be scientific and standardized. For instance, there should be requirement and regulations for the qualitative characteristics of information, measurement methods, and also flexible provisions that allow for necessary amendments.

1.2.2 Accounting Objectives

Accounting is the objective of accounting theory studies. Accounting studies require clear understanding of objectives. Accounting objectives are a critical part of accounting theory framework. The goals of financial accounting is to provide data and related information that reflect the company's operation, and therefore serves for economic decision-making.

1.2.3 Elements of Accounting

Elements of accounting include financial positions of the entity at a specific point of time and the types and scales of the operational performance over a period. The 6 major elements are assets, liabilities, revenues, profit, owner's equity, and expenses.

1.2.4 Accounting Assumptions

Accounting assumptions help to create an ideal entity and to lay down the premises for recognition and measurement so that irrelevant and disturbing factors are eliminated and the accounting study is idealized. Accounting assumptions serve as the basis for accounting elements, principles, methods, practices, and audit.

1.2.5 Accounting Practices

Accounting practices are a combined process of both accounting theories and routines. Theories are tackled with in the form of studying the nature and patterns of accounting management system, and exploring innovations of the system and implementation of accounting policies. Meanwhile, the later means building and improving financial accounting management system, including staffing accountants, establishing accounting organizations, and enacting accounting regulations and policies.

1.3 The Situation of Financial Accounting

The concept of financial accounting appeared in 1930s. Looking through its over 60 years' history, we found that all the critical progresses in financial accounting shared a similar pattern: with the increasing efficacy of reporting to external parties as the goal, reforms on recognition, measurement, and reporting (disclosure) of financial accounting took place, which later extended to financial principles that regulated recognition and measurement. The background and logic of financial accounting have suggested that its development is destined to be closely linked to providing accounting information to external parties. We could even say that one of financial accounting's ultimate goal is to provide external stakeholders with accounting information. It should be noted that financial accounting, since emerged, has always developed hand in hand with regulations

and scrutinies of accounting information and financial accounting disclosure.

Even though the separation of owner (ownership) and manager (control) began in the earlier age of accounting, it became increasingly common after financial accounting took over. (In modern times, large joint stock limited corporations boast unparalleled number of shareholders. But it also should be pointed out that amongst the large numbers of shareholders, some are in fact unable to control the managers. On that account, they are generally not considered owners.) Generally accepted accounting principles, development of capital market and corporate governance, restraining from independent audit, academic researches have all contributed to the fact that the development of financial accounting in the 20th century was a process of inheriting and reforming traditional accounting. Financial accounting adopted widely accepted and effective accounting conventions that were testified in traditional accounting practices. More specifically, financial accounting has preserved some excellent essence from traditional accounting in terms of the four basic processes, namely: Measurement, recognition, recording, and reporting. Both financial accounting and traditional accounting consist of these four processes, whereas the former centers on reporting.

2. CHALLENGES FACED BY FINANCIAL ACCOUNTING

2.1 Challenges Stemming from Economic Environment

Today, traditional accounting is still the main stream in China, which suits the current economic environment. However, as the environment gradually changes, the dominance will be broken and e-accounting will be the future. With the prevalence of internet in China, 21 century sees dramatic improvement of high-technologies and managerial abilities. Especially, e-commerce (it is based on digitalization and transferring of business transactions and datas, encompassing both conventional and new activities related to products and services) attracted attention from more and more companies. Its essence is the informatization of every business process. The evolvement of e-commerce greatly impacts traditional accounting, and creates huge room for emergence of new and more effective accounting models. A new form of accounting information system that is built in internet environment—e-accounting—will appear. (The meaning of internet environment here is two-folds: One is the internet outside the business, which enables information sharing and communications between the company and its trading partners and customers; the other is the intranet, which allows communication and sharing among departments inside the firm.) It will certainly influence

many aspects of accounting, such as the recognition, measurement and reporting.

2.2 Challenges from Production and Business Operation

The rapidly growing Information Technology industry is about to take over manufacturing industry's place as the largest sector. In the industrial age, businesses are production-centric, which also means the internal control system majorly covers the production process. However, in the age of Information Technology, more attention were paid to R&D, employee training, market research, designing, planing, marketing, internal communication, and so on. All these information activities mentioned above create values that are taking increasingly higher proposition in the overall values of the products/services the business provide. Almost all goods/services are transforming from labor or capital intensive ones into IT intensive ones.

2.3 Challenges Coming from Organizational Structures

In industrial age, corporations adopted a vertical hierarchy organizational structure that is comprised by multiple layers. Moreover, the different functions, such as market research, sales, production, engineering, accounting, and finance, are separated (i.e. strict work specialization). Added with unsophisticated feedback and information transferring methods, the structure led to poor response to situations and high management cost. Stepping into the age of Information Technology, organizational structures show new features: (a) Work specialization is no longer the guiding principle for division of labor (Wang, 1995). Departments in the company perform different functions. For instance, production department may at the same be responsible for direct-sale, accounting, and finance, whereas the sales department may also be in charge of market research, accounting, finance, and engineering. (b) The middle management, which served as a link between top management and employees, will no longer be as important as before. With sophisticated communication system, there is even no need for so many layers of management (Gates, 1996). (c) The prevalence of computers and the increase of information processing capability facilitates the information transferring through superiors and subordinates, across different departments, and between the business and the outer environment. Furthermore, companies are able to tackle changes with swift and uniform strategies and actions. Such is the case with Microsoft—e-mail offers convenient communication, and thus, to some degree, diminished the hierarchy between the general manager and other staffs in the company (Gates, 1996). "IT improvement tremendously reduced the cost of internal information sharing within the organization, triggering the collapse of the vertical hierarchy". "The distance between decision makers and

executors will narrow down and ultimately disappear" (Wang, 1995). The organizational structure will become a network, which is the essence of "horizontalization".

3. TRENDS AND SOLUTIONS

3.1 Trends

The arrival of IT age and the changes of user's demands on accounting information have created new room for financial accounting's future development:

3.1.1 "Green" Accounting

The concept of "green management" is now spreading from developed countries to developing countries. An environment-caring business can sustain a sound relationship with the government and the public. And it can reach the goal of environment protection by economic measures, laying down crucial responsibility on the accounting. Many authoritative international organizations are calling for producing "green GNP". And to implement the "green GNP" becomes an important task for accountants and statisticians. UNESCO casted a doubt in the article *The 21st Century Problems We Have to Negotiate*—"are we ready for the twenty-first century?" This question shows that eco-environmental problems in the 21 century are extremely severe and stubborn, and have to be solved immediately. In fact, environment deterioration hasbrought about so much impact on human beings that it also changed traditional theory of firms—the boundaries of firm is becoming invisible. A company, as the convergence of a series of contract, has contracts with societal interests/universal interests. This could be seen in the fact that "green consumption" has urged corporations to change from shunning environmental problems to proactively taking part in solving them. Investment in environmental protection becomes a forward-looking action that would help the firm to drive down energy consumption, to open up market, and to maximize profits.

3.1.2 Accounting Harmonization

Accounting harmonization, by scientific definition, is to limit the differences of individual accounting practices so as to enhance the comparability. International harmonization in accounting has become the major trend around the world. The goal of harmonization is to reduce conflicts in accounting principles among different countries, and to make financial information more comparable across countries. Harmonization may happen among regions.

3.1.3 Technology Support

In US, listed companies are already required to disclose the full financial statements online within 24 hours of statement's completion. But the ensuing challenge is how to guarantee the quality of online information. Many signs have suggested that US accounting firms are trying to ultimately change the usage of online financial

information. Additionally, the ongoing informatization in modern corporations means that, in the age of internet, accounting systems in individual companies are no longer isolated island, but parts of an integrated information. In societies with centralized political or economical system, accounting is seen as one or part of an economic management tool. But in commercial economy or the early age of market economy, there were no tight rules or regulations. Under such circumstances, accountants need to handle the accounts and make financial statements reply not only on theories and practices but also their rich experiences, skills and judgements. Accounting was therefore, by then, regarded as an art. However, following up were the problems of reliability and comparability of the information, which could lead to lawsuits and even financial/market crisis. As a result, multiple accounting standards were created to overcome the difficulties. In the modern time, emergence and development of new information technology and new forms of economy (e.g. cyber economy, knowledge-based economy), has given accounting more technical support and at the same time challenges. The support mainly contributes to online information disclosure. For instance, the globe-wide internet has been progressing very fast and applied on accounting information transferring. It defeated geographic constrains, making rapid and effective transferring a possibility.

3.2 Solutions

China, as a country without a complete industrial-age-accounting-model, is yet faced with challenges brought by the information technology age. However, this may well serve as an opportunity for China's jump start in accounting reform and development. Accordingly, the followings should do:

(a) Learn from western accounting theories and methods.

We should also pay attention to the premises when studying and applying western accounting theories or methods. The differences between China's and foreign accounting environment should be noticed. If studies show that the premises are reasonable, we should then try to fulfill them and afterwards bring in the desired reform.

(b) Enact and improve regulation and legislations.

We should draw lessons from foreign studies and experiences, and meanwhile establish a set of regulations and rules on management and disclosure of e-accounting information which fit with China's reality. First, e-commerce should soon be legislated, meaning payment, transactions, and accounting of online business will be regulated. On top of that, there should be rules that clarifies e-accounting information quality standards, obligations and responsibility of online disclosure on the company's part, and regulators and their rights and

responsibilities, which as a whole would create a sound environment for e-accounting information system.

(c) Step out of conventions and embrace new ideas.

Living in the fast-changing world, we have no other ways but to proactively adapt to it. We should face the real changes and trends, step out of conventional thoughts, and conduct some ahead-of-time studies. "Some things we are familiar with will be put aside; some unfamiliar things are forcing us to act on".

CONCLUSION

It is crucial to understand the patterns of accounting development. Especially in our age when economy and society progresses rapidly, grasping accounting trends timely plays a fatal role in a business and even a country's existence and thriving. In that case, we should promptly seize the trend, and study more about financial accounting. Meanwhile, we should understand the history of financial accounting—only on the basis of the past can we better catch the future trend.

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