CHAPTER 5

PROBLEMS IN ACCOUNTING PRACTICE

Problems are integral part of any activity. Running a business also entails many problems. All types of business enterprises, whether big or small, face various types of problems from the start of the business. Growth of business depends to a great extent, upon how these problems are resolved. In this chapter the researcher has made an effort to elaborate the problems in the field of accounting faced by the sample business enterprises under study. The main focus will be on problems relating to accounting practice.

1. Problem of Legal Entity and Unlimited Liability:

One important problem faced by the sole proprietorship and partnership firms is that the owner and the business are inseparable. The only exception is that a partnership firm is a legal entity for tax purposes. A sole proprietorship business entity is not a separate legal entity. Any legal issue that may affect the business will also affect the owner of the business. The costs of the business are also the costs of the owners and the profits of the business are the owner's income. When a taxing authority taxes a sole proprietorship entity, it is the same as taxing the owner's income. In case of partnership firm, any partner acting on behalf of the firm as per the
partnership deed can bind the firm and thus the firm faces all the liabilities. If the firm’s property is not enough, then personal property of the partners will be attached to pay the debts of the firm. A partnership firm is generally not regarded as a separate entity except for tax purposes. As per section (4) of Indian Partnership Act, 1932, ‘partnership’ is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. This definition establishes inseparability in personal relation among the partners.

2. Problem relating to Accounting Period:

In India customs and rituals have their own influence on accounting period concept for business. The centuries old Bengali and Assamese New year’s celebration include an important tradition, that is, opening the ‘Halkhata”, which means, a new ledger book for the beginning period of the business. Things have not been changed in the span of several generations and according to many of the owners of the sample enterprises, the opening of halkhata is an important day for them. The ledger book is to be commenced through worship and prayer.

On the other hand all sample business enterprises follow financial year, i.e., 1st April to 31st March, as the accounting year for reporting to VAT and other tax authorities and to the financial institutions, if any loan is taken. During field visit it is reported by a few owners of business firms that
though ledger book is to be commenced through worship and prayer on the day of halkhata, for all practical purpose they follow 1st April to 31st March as the official accounting year. This is because they are compelled to file returns as per the rules under various tax authorities. Again computer software is prepared considering the financial year from 1st April to 31st March. Hence, accounting period as per computerised accounting is designed for a period of 1st April to 31st March, which is commonly applicable for all the enterprises under survey, irrespective of their religious practice in maintaining accounts. At the same time it is also reported that they observe ‘Halkhata’ as per their tradition and rituals as it is the indigenous books of accounts maintained by all the business enterprises.

From the field enquiry conducted by the researcher upon the sample business enterprises, it is revealed that ‘Lalkhata’ (Red Book) folded with red cover is the original accounting records used by the proprietor for his understanding business results. It is also found in some cases that they hire a traditional professional accountant who is conversant with both lalkhata and the computer software. The traditional accountant visits the work place generally in the evening part and converts the indigenous figures of rupee from the lalkhata to official accounts for tax and other purposes. Some of these accountants also transform these accounts into software with the help of source documents. The financial statement officially required for tax return purposes, institutional borrowings purposes are prepared out of
software generated information. However, the indigenous accounts are treated as important document for evaluation of business results by all owners of sample enterprises and these are also respected by the tax authorities.

3. Problems in understanding accounting intricacies:

Another problem faced by the sample business enterprises is that some of them do not know the accounting language and intricacies related to the maintenance of accurate financial information. Field survey reveals that out of a total of 200 samples, 188 i.e., 94 percent have accounting knowledge and 12 i.e. 6 percent do not have accounting knowledge (table 3.3, chapter 3). On enquiry it has been found that they do not possess adequate accounting knowledge to maintain books of accounts and preparation of final accounts and statements. Most of them do not have a clear concept on double entry book keeping and the meaning of debit and credit. They do not know the concept of revenue and capital items. They also lack a clear concept of cash basis and accrual basis of accounting. They are supplied with formats of Profit and loss account and Balance sheet by the regulating agencies and they take help from other persons to prepare these statements. It is also expressed by a few respondents that they shall take training on ‘how to maintain accounts?’ Since everything is proceeding appropriately, and no objection is received from the VAT and other
authorities, all of these respondents are complacent with the present status of work.

4. **Knowledge of computerised accounting:**

   The study reveals that none of the sample respondents maintain accounts only on manual basis. Out of the total of 200 respondents, 37 percent maintain accounts only through computerised system and 63 percent use both manual and computerised accounting. Again from the table 3.7, it is revealed that only 03 percent of sample business entities maintain their accounts themselves, while in case of 77 percent accounts are maintained by the employees. However, in case of the rest 20 percent it is found that accounts are maintained by both owners and employees.

   It is reported by some of these respondents that though they know handling of computer, they do not know computerised accounting system. Most of the respondents express their desire to know computerised accounting system, but due to time constraints and lethargy to handle computer, the work is left either to the employees or they take hired services for the purpose of accounting.

5. **Problem related to Valuation of stock:**

   Problem in valuation of stock is mostly reported by the dealers in grocery items. Since the prices of grocery items fluctuate frequently, it
becomes very difficult to find out the total value of all the items on a particular date. Very few respondents have the knowledge of pricing methods of stock, viz., FIFO, LIFO etc. But interestingly all of the respondents show current stock position as per legal requirements and also show the value of stock in hand in the balance sheet and in the statements furnished to the tax authorities, banks and insurance companies. These respondents calculate the values of stock from their cost records without applying any of generally accepted methods, viz., FIFO, LIFO etc. This has influenced the profit figures and also the value of assets. Although they may not be familiar with sophisticated terminology of financial accounting or cost accounting but that does not hinder their business as a continuous process of economic activity and they are otherwise knowledgeable in running their business affairs. During field survey the researcher realises that they are very much cost conscious while displaying their stock position in terms of quantity and price, carry forward from earlier day and the present position as on the reporting date.

6. **Problems relating to Bad Debt and Depreciation Provision:**

    Insofar as debtors are concerned it is found that they do not provide any provision for doubtful debts. If any trade debt is not recovered within a reasonable period of time then only it is recorded as not recoverable and is treated as bad debt. But such a system may create problem in ascertaining
true and fair profit which is taxable. When goods are sold on credit in one
accounting year and such debtor is treated as bad debt in the subsequent next
accounting year, then it is obvious that the profit of the year in which goods
were sold, is not the true profit. It is also found that, the sample business
entities charged the amount of bad debts against their income in profit and
loss account as admissible as per Income Tax Act, 1961.

In case of fixed assets it is found that depreciation is charged for the
assets which are owned by the firm and used in the business at the rates
prescribed under the Income Tax Rules. Again, in case of sole proprietorship
firm, if any motor vehicle or other assets which is in the name of owner, is
used for the business, the full amount of depreciation or a part there of on
such asset, is charged as depreciation and is shown in the final account
following the provisions of Income Tax Act, to get tax benefit. But no
depreciation fund is created to replace the assets. Here, the replacement
decision and the finance needed at the expiry of the estimated useful life of
the asset have to be provided by the proprietor himself from his own
personal resource or has to take loan. Hence, providing for depreciation is
not at all significant for the enterprises under survey.

7. Problems related to Revenue Recognition:

Another important problem observed during the study is related to
Revenue Recognition. In most of the cases accrued incomes are not
recognised as income for the period under review, whereas rent payable is treated as expense of the concerned month and year for the reporting period. Purchase of a calculator for office use is accounted for as an asset by some of the business entities while some others has treated it as an office expense. It is reported by some business entities that if goods are taken by the owner/s for personal or household consumption, they do not record such amount of goods taken in the books of account as their drawings. The researcher therefore feels that stocks depleted in the business for personal consumption is not recognized as a drawings and as such not recorded. This practice reinforces the inseparability of business firm from the owner. It is not considered material whether stock of goods is lying within business or taken out of business for self consumption.

Thus such types of problems have occurred due to (a) absence of recognition of business as a separate economic entity, and (b) lack of accounting knowledge on (i) accrual and cash concept, (ii) revenue and capital expenditure, (iii) matching concept and (iv) the revenue recognition.

Above mentioned problems arise mostly due to inadequate knowledge of accounting concepts possessed by the respondents. During field survey the respondents have expressed some other problems also. These are briefly mentioned below.
(i) **Lack of time:** Another problem faced by the sample business owners is that they could not give the time which is required for maintenance of accounts and preparation of final accounts and other statements.

(ii) **Lack of interest:** Another problem faced by the sample business owners is that they have less interest in maintenance of books of accounts and preparation of final accounts and other statements.

(iii) **Accommodation for accounts staff:** Another problem faced by the sample business owners is that they cannot provide sufficient accommodation which is required for the accounts staff due to scarcity of space and very high amount of rent. To arrange for additional space means that they have to bear additional amount of expenses as rent. Again it also sighted that space is not available at the business place. It is also observed that some owners are not interested to have spacious accommodation due to high rate of rent. For all these reasons they cannot employ sufficient number of employees as accounts staff and they find no alternative but to maintain the books of accounts with the help of hired person from outside.

Further, in course of field visit, the present researcher gathered a piece of information attributed to the problems of accounting. When it is reported that a rental accommodation at a given amount of monthly rent is available, but to get this accommodation the concerned business entity has to deposit an amount exceeding several lakhs of rupees as a security money
(in colloquial language it is known as ‘Salami’), which in some cases is adjustable against monthly rent and in other majority case it is non-adjustable and non-refundable to the tenant. Further, the amount of salami cannot be paid in cheque and it must be in the form of liquid cash. Such salami amount paid in cash all over the country in a similar situation is attributed to the cause of unaccounted money circulated in the hands of real estate owners. Uptil now, the amount cannot be brought within a recognized source of income nor could it be brought under any tax net.

(iv) **High installation cost for computerisation of accounts:** Some business entities could not computerise their own accounting system due to heavy cost involved in installation of computer both in software and hardware. However these business entities get the accounts prepared in accounting software by hiring such services.

The overall observation regarding maintenance of books of accounts and preparation of periodical or final accounts is that the owners of sole proprietorship and partnership business entities mostly engage themselves in various activities relating to buying and selling of goods. They think that maintenance of books of accounts and preparation of accounts is a time consuming process and if they utilise this time in trading activities, their turnover will be increased contributing to higher revenue flow. Again maintenance of books of accounts and preparation of accounts is a very expensive matter as it increases the amount of expenditure in giving salary
to accounts personnel, in paying high rent for accommodation, hiring charges to accounts people outside the business etc. Monitoring and supervising of accounts personnel will involve additional cost in maintaining separate accounts cell within the organisation. This observation is equally relevant because they all are pursuing their economic activities either as a sole proprietor or partnership firm.

(v) **Filing of tax return:** From the field survey it is found that the sample business entities faces some problems while filing their tax return to the concerned authorities such as, Assam Value Added Tax department and Income Tax department. The main problem in relation to filing of tax return is that they are not fully aware about the various provisions and rules of these acts. Again changes of income tax rules in every financial year and changes in AVAT rules confused them about the latest status or position of these provisions and rules. Further some of the sample business owners said that they do not want to face the tax officials to meet the quarry or observations which are pointed out by the officials in their official procedure.

Thus there are many problems faced by the sample business firms under study and this may be safely said that these problems are equally faced by most of the business firms in the city of Guwahati. But it is also opined by most of the respondents that despite the constraints they have to carry their business in a positive mood with an effort to solve these
amicably and within the ambit of law. It is also reported by these respondents that the problem of accounts keeping and preparation of financial statements is not at all a serious problem and can be resolved with the help of experts in accounting profession.