

Chapter 1 • Accounting: The Language of Business

TEACHING OBJECTIVES

- 1-1) Define Accounting.
- 1-2) Identify and discuss career opportunities in accounting.
- 1-3) Identify the users of financial information.
- 1-4) Compare and contrast the three types of business entities.
- 1-5) Describe the process used to develop generally accepted accounting principles.
- 1-6) Define the accounting terms new to this chapter.

SECTIONS

- 1. What Is Accounting?
 - 2. Business and Accounting
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CHAPTER OVERVIEW/ LEARNING OBJECTIVES

- 1. This chapter introduces basic **accounting concepts and terms**. It discusses the importance of good accounting information to all forms of business.
- 2. The chapter identifies and discusses **career opportunities** in accounting including: public accounting, private company accounting, and governmental accounting.
- 3. In addition, the various **users of accounting information** are identified including: owners/managers, suppliers, banks, tax authorities, regulatory agencies, and investors as well as non-profit organizations.
- 4. The chapter compares and contrasts the three **types of business entities**: Sole proprietorships, partnerships, and corporations.
- 5. The final section of the chapter describes the process used to **develop generally accepted accounting principles**—including the importance of the FASB in this process and the importance of compliance by companies.

"At the beginning of the chapter, there is a paragraph about Google. Let's read this together."



Ask. . . "So, what do you think? If you were considering becoming a stockholder in Google, why would it be important for you to have a basic understanding of accounting?"

Answer---A basic understanding of accounting would assist in the interpretation and analysis of financial statements released by a company like Google, and would therefore make the financial position of the company more clear and a decision to purchase (or not purchase) its stock more straightforward

FAST FACTS:

Most students cannot imagine their life without Google.

In 1995 Google's founders Larry Page and Sergey Brin developed this online search tool that took root in a Stanford University Dorm room.

By 2000 Google became the world's largest search engine with its introduction of a billion-page index. .

Revenues topped 50 billion for the first time in 2012.



Ask if any of your students have checking accounts. Have students compare the check writing process to the accounting process.

Section 1. WHAT IS ACCOUNTING?

A. The Need for Financial Information



Ask students what type of financial information they would need to operate a business successfully.

- Explain that accounting provides a format to organize data into meaningful information.

Objective 1-1

B. Accounting Defined

- Write the word **accounting** on the board and underline the root *count*.



Ask students "What do you do when you count?"

- Point out parallels between answers and the five accounting functions:
 - Record
 - Classify
 - Summarize
 - Interpret
 - Communicate

Chapter 1

Accounting: The Language of Business

Section 1: What Is Accounting?

Section Objectives

- 1-1 Define accounting.
- 1-2 Identify and discuss career opportunities in accounting.
- 1-3 Identify the users of financial information.

In running a business, you need answers to questions:

- How much cash does the business have?
- How much money do customers owe the business?
- What is the cost of the merchandise sold?
- What is the change in sales volume?
- How much money is owed to suppliers?
- What is the profit or loss?

Objective 1-1 Define Accounting

QUESTION:

What is accounting?

ANSWER:

Accounting is the process by which financial information about a business is classified, recorded, summarized, interpreted, and communicated to owners, managers and other interested parties.

QUESTION:

What are financial statements?

ANSWER:

Financial statements are periodic reports of a firm's financial position and operating results.

Objective 1-2 Identify and discuss career opportunities in accounting

Many jobs are available in the accounting profession. Some examples are:

Bookkeepers & Accounting Clerks **Financial Analysts**

Financial Managers

Accountants generally work in one of these areas:

Public accounting
Managerial accounting
Governmental accounting

Public accounting firms provide services such as:

- Auditing
- Tax accounting
- Management advisory services

QUESTION:

Who is a certified public accountant?

ANSWER:

A certified public accountant, or CPA, is an independent accountant who provides accounting services to the public for a fee.

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- Write the answers on the board.
- Discuss the need for accountants and accounting skills by pointing out that some form of accounting directly or indirectly affects everything we do (home, school, shopping, entertainment).
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- ◆ **Public Accounting**—Careers in public accounting include auditing, tax accounting, and management advisory services.
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- Explain that careers in public accounting include auditing, tax accounting, and management advisory services.
- Point out that auditing is the review of financial statements to assess their fairness and adherence to GAAP.

- Objective 1-2

C. Accounting Careers:



Ask students questions like "Why should we study accounting?" or "Why are you here?"

QUESTION:
What is managerial accounting?

ANSWER:
Managerial accounting includes a wide range of work carried on by an accountant employed by a single business in industry.

Managerial Accounting, or private accounting, involves working for a single business to:

- Establish accounting policies
- Provide financial advice to management
- Manage the accounting system
- Prepare and interpret financial statements
- Prepare tax forms and do tax planning
- Prepare internal reports for management

QUESTION:
What is governmental accounting?

ANSWER:
Governmental accounting involves keeping financial records and preparing financial reports for a federal, state, or local governmental unit.

Governmental accounting involves keeping financial records and preparing financial reports as part of the staff of federal, state, or local governmental units, such as:

- Securities and Exchange Commission (SEC)
- Internal Revenue Service (IRS)
- Federal Bureau of Investigation (FBI)
- Homeland Security (DHS)

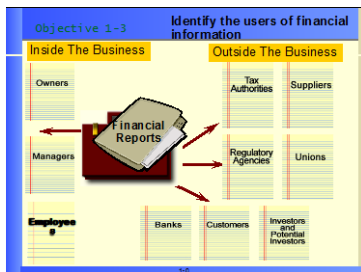
- Explain that tax accountants not only prepare tax forms, but also help taxpayers reduce their tax liability.
- Describe how accountants perform management advisory services to help clients improve business performance.

◆ **Managerial Accounting**—Also referred to as private accounting, involves working for a single business in industry. Managerial accountants perform a wide range of activities.

- Explain that managerial accounting involves working for private businesses directing the accounting system, preparing financial statements, budgeting, and planning.

◆ **Governmental Accounting**—Involves keeping financial records and preparing financial reports as part of the staff of federal, state, or local governmental units.

- Explain that government accounting includes accounting for government agencies as well as regulation of certain industries.
- Indicate that the SEC reviews financial statements of companies under its jurisdiction.
- Inform students that the FBI, IRS, and Homeland Inform students that the FBI, IRS, and Homeland

Objective 1-3**D. Users of Financial Information:**

- ◆ **Owners and Managers**--Owners need information that will help them evaluate the results of their operations and plan and make decisions for the future.



Ask students "What are some possible decisions that owners might need to make about their business?"

- ◆ **Suppliers**—Businesses that extend you credit for purchases the business makes.
- ◆ **Banks**—Banks must ensure that the business is capable of repaying a loan.

- ◆ **Tax Authorities**— The IRS, and other state and local taxing authorities.



Ask students, "Now, why would the IRS be interested in how much money a business makes?"

- ◆ **Regulatory Agencies and Investors**—An example would be the SEC, who oversees the financial information provided by public companies.

**Inform students that a major change in the regulatory environment for accountants was the passage in 2002 of the *Sarbanes-Oxley Act*.



Ask students "Does anyone know what the *Sarbanes-Oxley Act* was designed to do? If you

Suppliers

Use financial information to:

- Assess the firm's ability to pay its bills.
- Set a credit limit for the firm.

Banks

Use financial information to:

- Decide whether to make a loan.
- Determine the terms of the loan.

Tax Authorities

Use financial information to determine the tax base for:

- Income taxes
- Sales taxes
- Property taxes

Regulatory Agencies and Investors

- The Securities and Exchange Commission (SEC) is the federal agency that oversees the financial information of public corporations.
- Public corporations are those whose stock is traded on stock exchanges and over-the-counter markets.

Sarbanes-Oxley Act

The Act led to a major change in the regulatory environment.

The Act was designed as a regulatory crackdown on corporate fraud and corruption.



Customers

Use financial information to:

- Determine the economic health of the business
- Determine the likelihood that the firm will remain in business to provide parts, service, and support

Employees and Unions

Use financial information to:

- Negotiate wages and benefits
- Monitor profitability of profit-sharing plans

look in your text, there is a boxed in area discussing this important law."

-Answer--It was designed to crack down on corporate fraud and corruption.



Ask students, "What types of financial information would you need if you were thinking about investing in a business?"

Answer—There are lots of items investors might need. (dividends paid, property owned, sales, net income.)



Ask students to call out the types of financial information they think customers of a business might need. (How long has the company been in business? Is it likely to remain in business?)

◆ **Customers—**Before a customer buys a product from a business, they may want to make sure that the business will be around later to service the product if problems arise.

◆ **Employees and Unions—**



Ask students, "Why would *unions* be interested in knowing how much money a business is making?"

If you were going to work for someone as an employee, you would have a vested interest in their financial viability.

Chapter 1

Accounting: The Language of Business

Section 2: Business and Accounting

Section Objectives

1-4 Compare and contrast the three types of business entities.

1-5 Describe the process used to develop generally accepted accounting principles.

Objective 1-4 Compare and contrast the three types of business entities

Three major legal forms of a business entity:

Sole Proprietorship

Partnership

Corporation

QUESTION:

What is a sole proprietorship?

ANSWER:

A sole proprietorship is a business entity owned by one person who is legally responsible for the debts and taxes of the business.

	Sole Proprietorship	Partnership	Corporation
Ownership	1 owner		
Life	Ends when owner: • is unable to carry on, • dies, or • closes the firm		
Responsibility for business debts if firm is unable to pay	Owner		

QUESTION:

What is a partnership?

ANSWER:

A partnership is a business entity owned by two or more people who are legally responsible for the debts and taxes of the business.

	Sole Proprietorship	Partnership	Corporation
Ownership	1 owner	2 or more owners	
Life	Ends when owner: • is unable to carry on, • dies, or • closes the firm	Ends when partner(s): • withdraws, • dies, or • closes the firm	
Responsibility for business debts if firm is unable to pay	Owner	Partners individually and jointly	

Section 2. BUSINESS AND ACCOUNTING

Objective 1-4

A. Types of Business Entities--There are three major business entities:

◆ Sole Proprietorships—a business entity owned by one person.

- Explain that the life of the business ends when the owner dies.
- Indicate that the owner is responsible for all debts of the business.
- **Good Example--Tell students that a little old lady slipped and fell on some ice in the front of your store. Since you are a sole proprietorship, she could sue you personally for her injuries—there goes your personal savings account...

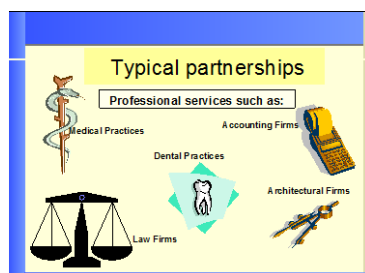
◆ Partnerships—a business owned by two or more people.

- Explain that partners are responsible for all debts of the business.

◆ Corporations— Is the only form of business that is a separate *legal* entity.

(It is an artificial person in the eyes of the law.)

- Explain that the life of the corporation is unlimited and ends only when the



Partners must agree upon:

- Amount each partner will contribute to the business.
- Percentage of ownership of each partner.
- Share of profits of each partner.
- Duties each partner will perform.
- Debts - the responsibility each partner has for the partnership's debts.

business can no longer operate because of financial failure or stockholder's vote to liquidate.

- Explain that the stockholders (owners) are not responsible for debts of the business.

****Example--**Tell students that the little old lady slipped and fell again on some ice on the steps of your store—now she can only sue for the assets of the company. The owner's personal assets are safe.



Ask students if they can write down on a piece of paper the three types of business entities that were discussed. Can they remember one important aspect of each?

- ◆ **Explain the term *Separate Entity Assumption*** —A business's accounting records should always be kept separate from the owner's personal accounting records.



Ask students, "If a person owned a dog- poop-scooping business, a pizza parlor and a woman's lingerie shop, how many sets of books would he have to keep? (Answer=4, one for each business and one for his personal records.)

QUESTION:

What is a corporation?

ANSWER:

A corporation is a publicly or privately owned business entity that is separate from its owners and has a legal right to own property and do business in its own name; stockholders are not responsible for the debts or taxes of the business.

	Sole Proprietorship	Partnership	Corporation
Ownership	1 owner	2 or more	Can be one or thousands
Life	Ends when owner: • is unable to carry on, • dies, or • closes the firm	Ends when partner(s): • dies, • close the firm • withdraws	Continues indefinitely; ends when: • business goes bankrupt • stockholders vote to liquidate
Responsibility for business debts if firm is unable to pay	Owner	Partners individually and jointly	Stockholders can lose only the amount invested

QUESTION:

What is stock?

ANSWER:

Stock is issued in the form of stock certificates, and represents the ownership of the corporation.

Important Distinction

For accounting purposes, all forms of business entities are considered separate entities.

However, the corporation is the only form of business that is a separate legal entity.

QUESTION:

What is the separate entity assumption?

ANSWER:

The separate entity assumption is the concept of keeping a firm's financial records separate from the owner's personal financial records.

Objective 1-5 Describe the process used to develop generally accepted accounting principles

QUESTION:

What are generally accepted accounting principles (GAAP)?

ANSWER:

Generally accepted accounting principles (GAAP) are accounting standards developed and applied by professional accountants.

B. Generally Accepted Accounting Principles—

Objective 1-5

- The rules that accountants follow to record business transactions.

◆ The Development of GAAP

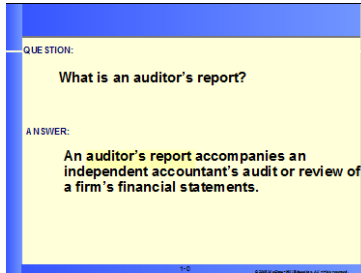
- Explain that GAAP are developed by FASB (Financial Accounting Standards Board) and are called Statements of Financial Accounting Standards.
- New principles are written every year and old ones are revised because the business environment is constantly changing.



Tell students to look at the text for more information on the FASB Accounting Standards Codification. Also accounting majors may be interested in reading more about the International Accounting Standards Board or IASB.

◆ The Use of GAAP

- Explain that companies must submit their financial statements to the SEC and must include an auditor's report which provides an objective opinion on the fairness of the financial reports and compliance with GAAP.
- Explain that all publicly traded companies must use GAAP to report business transactions.



- Explain that if you are a publicly traded company, then you must hire an independent auditor to audit your financial statements to verify that you are complying with GAAP.
- Emphasize the importance of a favorable auditor's opinion.