



A Look at This Chapter

Accounting plays a crucial role in the information age. In this chapter, we discuss the importance of accounting to different types of organizations and describe its many users and uses. We explain that ethics are crucial to accounting. We also describe the meaning and source of generally accepted accounting principles.



A Look Ahead

Chapter 2 introduces the accounting equation and how it helps to describe business transactions. Chapters 2 through 6 show (via the accounting cycle) how financial statements reflect business activities.

Chapter

Introduction to Accounting

Learning Objectives

- LO 1** Explain the purpose and importance of accounting in the information age.
- LO 2** Identify users and uses of accounting.
- LO 3** Identify career opportunities in accounting and related fields.
- LO 4** Explain why ethics are crucial to accounting.
- LO 5** Explain the meaning of generally accepted accounting principles.
- LO 6** Identify the groups that establish generally accepted accounting principles.
- LO 7** Identify the three types of ownership structures.

A short article launches each chapter showing the relevance of accounting for a real entrepreneur. An **Entrepreneurs In Business** problem at the end of the assignments returns to this article with a mini-case.

“Ask everyone to give you money... remember, you hold the opportunity for them”

—Shawn Nelson

Love, Peace, and Profits



SALT LAKE CITY—Trying to get comfortable while watching TV, Shawn Nelson thought “a huge beanbag thing” would be far more relaxing than his old couch. So he made one—a big one! Seven feet across and shaped like a baseball, Shawn’s creation was the talk of friends and neighbors. Shortly after making and selling a few “huge beanbag things,” Shawn knew it needed a better name. Drawing on the 1960s retro spirit of “love and peace,” Shawn named his invention the **LoveSac** and his company (**LoveSac.com**) was born.

Yet LoveSac’s launch was anything but smooth. Shawn began by working out of his mother’s basement. He then set up shop at trade shows and even the local drive-in cinema. He got his first big break when **Limited Too** called after seeing his display at a trade show. “I answered the phone,” says Shawn, “Twelve thousand Sacs? Sure, no problem.” Who was he kidding?

Shawn’s debt swelled to over \$50,000 as he worked 19-hour days and slept in the aged building in which he manufactured the Sacs. “It nearly broke me emotionally, physically, mentally,” Shawn recalls.

“We finished the order but ate up all our profits.” Without profits his business, too, would soon be retro. So Shawn approached furniture retailers to ask if they would carry Sacs. “Shawn can still hear the laughter,” states LoveSac’s Website.

Just when things seemed bleakest, Shawn’s cousin suggested he open a retail location. Desperate, Shawn took a three-month lease in a shopping mall. His goal: sell one SuperSac per day. This would cover rent and pay him and his cousin a \$5 hourly wage. Shawn then developed a transaction-based accounting system to get a handle on orders and sales.

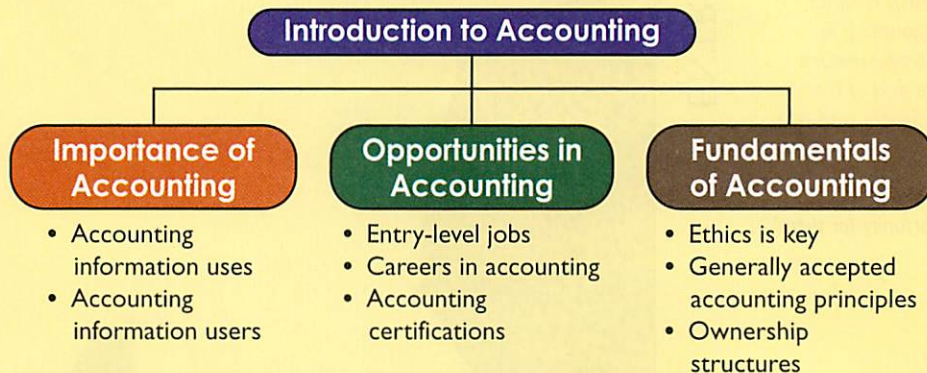
Incredibly, customers crowded into his store within days of opening. Four weeks later and just before Christmas, customers were lined up outside the door waiting for Sacs to arrive from the factory. By Christmas Eve, Shawn’s store was nearly sold out. Today, Shawn has more than 20 stores projected to generate over \$30 million in sales. With results like that we’d all love Sacs!

[Sources: LoveSac Website, January 2009; CNBC Business Nation interview, February 2008; Entrepreneur, November 2004; LA Confidential, Fall 2004; Life & Style Weekly, June 2005.]

A Preview opens each chapter with a summary of topics covered.

Today's world is one of information—its preparation, communication, analysis, and use. Accounting is at the heart of this information age. Knowledge of accounting provides career opportunities and the insight to take advantage of them. This book introduces concepts, procedures, and analyses that help

us make better decisions. In this chapter we describe accounting, the users and uses of accounting information, and career opportunities in accounting. We also emphasize the importance of ethics for accounting.



Importance of Accounting

LO1 Explain the purpose and importance of accounting in the information age.

We live in an information age—a time of communication and immediate access to data, news, facts, and commentary. Information affects how we live, whom we associate with, and our opportunities. To fully benefit from the available information, we need knowledge of how the information system collects, processes, and reports information to decision makers.

Accounting Information Uses

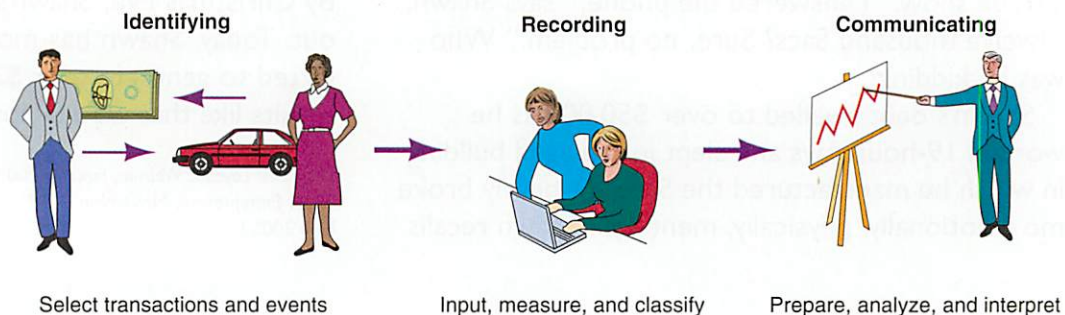
Providing information about what businesses own, what they owe, and how they perform is an important aim of accounting. **Accounting** is an information and measurement system that identifies, records, and communicates information about an organization's business activities. *Identifying* business activities requires selecting transactions relevant to an organization. Examples are the sale of iPods by **Apple** and the receipt of ticket fees by **TicketMaster**. *Recording* business activities requires keeping a chronological log of transactions measured in dollars and classified and summarized in a useful format. *Communicating* business activities requires preparing accounting reports such as financial statements. It also requires analyzing and interpreting such reports. (The financial statements and notes of **Best Buy** and **RadioShack** are shown in Appendix A of this book.) Exhibit 1.1 summarizes accounting activities.

Real company names are printed in bold magenta.

All aspects of business involve accounting. The most common contact with accounting is through credit approvals, checking accounts, tax forms, and payroll. These experiences tend to focus on the recordkeeping role of accounting. **Recordkeeping**, or **bookkeeping**, is the recording of transactions and events, either manually or electronically. This is just one part of accounting.

Exhibit 1.1

Accounting Activities

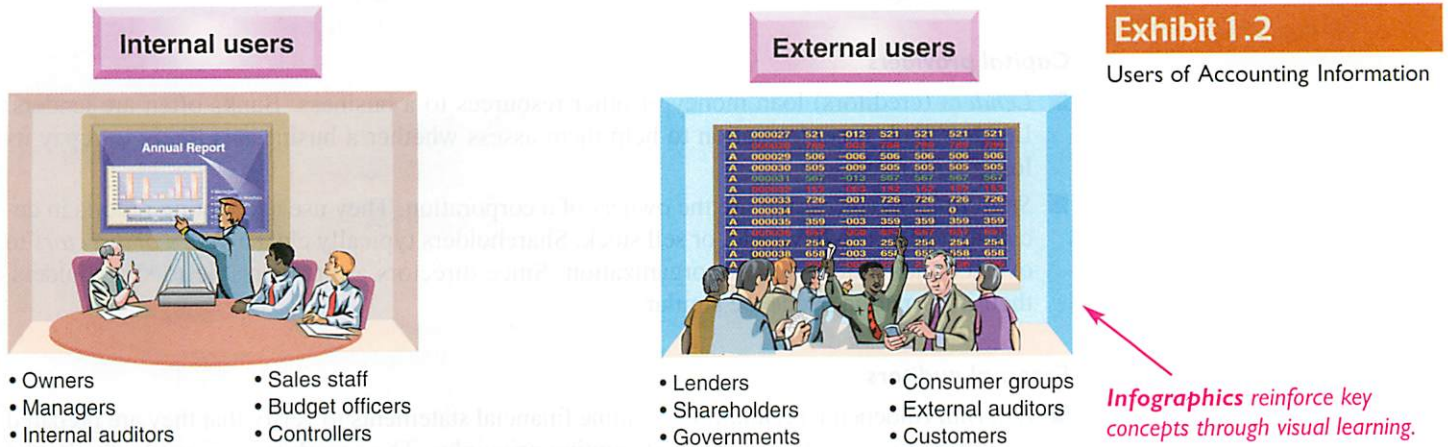


Accounting also identifies and communicates information on transactions and events, and it includes the crucial processes of analysis and interpretation.

Technology is a key part of modern business and plays a major role in accounting. Accounting software packages like *QuickBooks* and *Simply Accounting* reduce the time, effort, and cost of recordkeeping while improving clerical accuracy.

Accounting Information Users

Accounting is often called the *language of business* because all organizations set up an accounting information system to communicate information to help people make better decisions. Exhibit 1.2 shows that accounting users can be divided into two groups: internal users and external users.



Internal Information Users Internal users of accounting information are those directly involved in managing and operating an organization. They use the information to help improve the efficiency and effectiveness of an organization. **Managerial accounting** is the area of accounting that serves the decision-making needs of internal users. Internal reports are not subject to the same rules as external reports and instead are designed with the special needs of internal users in mind.

Several types of internal users rely on accounting reports, including:

Owners As the owner of **LoveSac**, Shawn Nelson needs accounting data to answer questions like:

- Are we keeping our production costs low enough?
- Should we expand into clothing and other accessories?
- Should we open more retail outlets?
- Do we need to borrow money?

Managers As a business grows, its owner often must assign managers to certain duties.

- *Purchasing managers* need to know what, when, and how much to purchase.
- *Marketing managers* use reports about sales and costs to target customers; set prices; and monitor customer needs, tastes, and price concerns.
- *Human resource managers* need information about employees' payroll, benefits, performance, and compensation.
- *Production managers* depend on information to monitor costs and ensure quality.
- *Distribution managers* need reports for timely, accurate, and efficient delivery of products.
- *Service managers* need to know the costs and benefits of looking after products and services.
- *Research and development managers* need information about projected costs and revenues of any proposed changes in products and services.

Internal auditors Internal auditors design and test their employer's internal controls. *Internal controls* are procedures designed to protect company property, ensure reliable reports, promote efficiency, and ensure employees follow company policies. Examples are good records, physical controls (locks, passwords, guards), and independent reviews.

LO2 Identify users and uses of accounting.

External Information Users External users of accounting information are *not* directly involved in running the organization. They include shareholders (investors), lenders, directors, customers, suppliers, regulators, lawyers, brokers, and the press. External users have limited access to an organization's information. Yet their business decisions depend on information that is reliable, relevant, and comparable.

Financial accounting is the area of accounting aimed at serving external users by providing them with financial statements. These statements are known as *general-purpose financial statements*. The term *general-purpose* refers to the broad range of purposes for which external users rely on these statements.

Each external user has special information needs depending on the types of decisions to be made, including the following:

Capital providers

- **Lenders** (creditors) loan money or other resources to a business. Banks often are lenders. Lenders look for information to help them assess whether a business is likely to repay its loans with interest.
- **Shareholders** (investors) are the owners of a corporation. They use accounting reports in deciding whether to buy, hold, or sell stock. Shareholders typically elect a *board of directors* to oversee their interests in an organization. Since directors are responsible to shareholders, their information needs are similar.

External auditors

- **External** (independent) *auditors* examine financial statements to verify that they are prepared according to generally accepted accounting principles. Their work is overseen by the Public Company Accounting Oversight Board (PCAOB).

Labor unions

- **Labor unions** use financial statements to judge the fairness of wages, assess job prospects, and bargain for better wages.

Regulators

- The Internal Revenue Service (IRS) requires organizations to file accounting reports in computing taxes.
- Utility boards use accounting information to set utility rates.
- The Securities and Exchange Commission (SEC) requires reports for companies that sell their stock to the public.

Business associates

- **Suppliers** use accounting information to judge the soundness of a customer before making sales on credit.
- **Customers** use financial reports to assess the staying power of potential suppliers.

IN THE NEWS

In The News highlight relevant items from practice.

They Fought the Law Our economic and social welfare depends on reliable accounting information. A few managers in recent years forgot that and are now paying their dues. They include L. Dennis Kozlowski of **Tyco**, convicted of falsifying accounting records; Bernard Ebbers of **WorldCom**, convicted of an \$11 billion accounting scandal, and Andrew Fastow of **Enron**, guilty of hiding debt and inflating income.



Entrepreneurs, particularly in small companies, perform many of the tasks demanded of both external and internal users, and thus rely heavily on accounting information.

HOW YOU DOIN'?

Answers—p. 13

1. What is the purpose of accounting?
2. What is the relation between accounting and recordkeeping?
3. Who are the internal and external users of accounting information?
4. Identify at least five types of managers who are internal users of accounting information.
5. What are internal controls and why are they important?

How You Doin'? is a chance to stop and reflect on key points.

Opportunities in Accounting

Entry-Level Jobs

Accounting offers many types of jobs. Typical education and experience requirements for common entry-level jobs are described in Exhibit 1.3 below.

L03 Identify career opportunities in accounting and related fields.

Job Title	Education	Experience
Accounting clerk	1–2 accounting courses	Little or none
Bookkeeper	1–2 years of accounting courses	Some as an accounting clerk
Accountant	Two-year or four-year college degree	Little or none

Exhibit 1.3

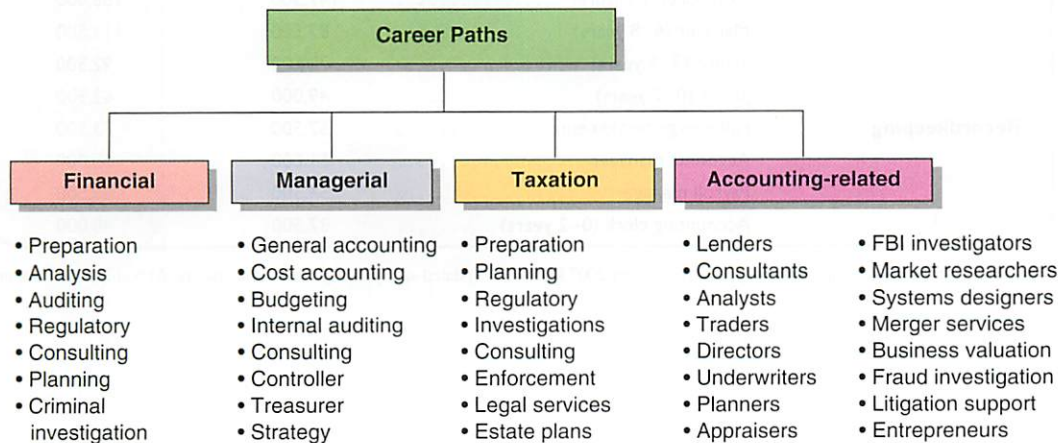
Common Entry-Level Jobs

Career Paths

Accounting has four broad areas of opportunities: financial, managerial, taxation, and accounting-related. Exhibit 1.4 lists selected opportunities in each area.

Exhibit 1.4

Accounting Careers

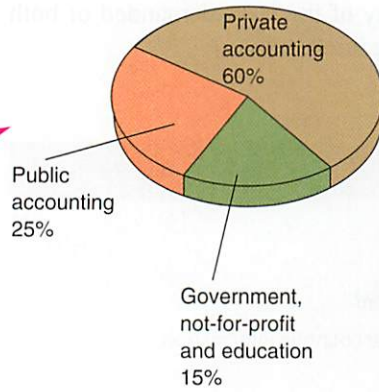


The majority of accounting opportunities are in *private accounting*, as shown in Exhibit 1.5. *Public accounting* offers the next largest number of opportunities. Private accountants are employed by a single company. Public accountants provide auditing, tax, and consulting work for

Exhibit 1.5

Accounting Jobs by Area

Graphical displays are often used to illustrate key points.



other companies for service fees. Still other opportunities exist in government (and not-for-profit) agencies, including business regulation and investigation of law violations.

Certifications

Accounting specialists are highly regarded. Their professional standing often is denoted by a certificate. Employers look for specialists with designations such as certified bookkeeper (CB), certified payroll professional (CPP), personal financial specialist (PFS), certified fraud examiner (CFE), and certified forensic accountant (CrFA). Certified public accountants (CPAs) must meet education and experience requirements, pass an examination, and exhibit ethical

character. Many accounting specialists hold certificates in addition to or instead of the CPA. Two of the most common are the certificate in management accounting (CMA) and the certified internal auditor (CIA).

Individuals with accounting knowledge are always in demand. Benefit packages can include flexible work schedules, telecommuting options, career path alternatives, casual work environments, extended vacation time, and child and elder care.

Demand for accounting specialists is booming. Exhibit 1.6 reports average annual salaries for several accounting positions. Salary variation depends on location, company size, professional designation, experience, and other factors. For example, salaries for full-charge bookkeepers average \$57,500 per year. Likewise, annual salaries for accounting clerks average \$37,500.

Exhibit 1.6

Accounting Salaries for Selected Fields

Field	Title (experience)	2007 Salary	2012 Estimate*
Public Accounting	Partner	\$190,000	\$242,500
	Manager (6–8 years)	94,500	120,500
	Senior (3–5 years)	72,000	92,000
	Junior (0–2 years)	51,500	65,500
Private Accounting	CFO	232,000	296,000
	Controller/Treasurer	147,500	188,000
	Manager (6–8 years)	87,500	111,500
	Senior (3–5 years)	72,500	92,500
	Junior (0–2 years)	49,000	62,500
Recordkeeping	Full-charge bookkeeper	57,500	73,500
	Accounts manager	51,000	65,000
	Payroll manager	54,500	69,500
	Accounting clerk (0–2 years)	37,500	48,000

*Estimates assume a 5% compounded annual increase over 2007 levels. For updated salary data go to www.aicpa.org, Abbott-Langer.com, or Kforce.com.

HOW YOU DOIN'? Answers—p. 13

6. What career opportunities exist in the taxation area?
7. What types of certificates are available in accounting?

Fundamentals of Accounting

Accounting is guided by concepts and principles. This section describes two key fundamentals of accounting.

LO4 Explain why ethics are crucial to accounting.

Ethics—A Key Concept

The goal of accounting is to provide useful information for decisions. For information to be useful, it must be trusted. This demands ethics in accounting. **Ethics** are beliefs that distinguish right from wrong. They are accepted standards of good and bad behavior.

Identifying the ethical path is sometimes difficult. The preferred path is a course of action that avoids casting doubt on one’s decisions. For example, accounting users are less likely to trust an auditor’s report if the auditor’s pay depends on the success of the client being audited. To avoid such concerns, ethical rules are often set. For example, external auditors are banned from direct investment in their client and cannot accept pay that depends on figures in the client’s reports. Exhibit 1.7 gives guidelines for making ethical decisions.

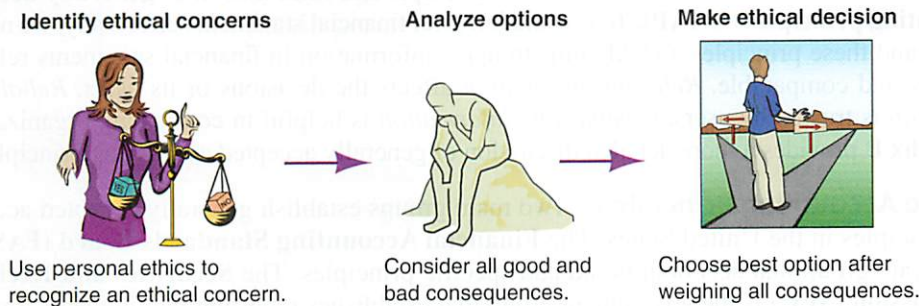


Exhibit 1.7

Guidelines for Ethical Decision Making

Providers of accounting information often face ethical choices as they prepare financial reports. These choices can affect the price a buyer pays and the wages paid to workers. They can even affect the success of products and services. Misleading information can lead to a wrongful closing of a division that harms workers, customers, and suppliers. There is an old saying worth remembering: *Good ethics are good business.*

Accountants have many sources of ethical guidance. For example, the American Institute of Certified Public Accountants’ *Code of Professional Ethics* is available at www.aicpa.org. The Institute of Management Accountants’ *Statement of Ethical Professional Practice* (at www.imanet.org) provides guidance on ethical principles and how to resolve ethical conflicts. The **Sarbanes-Oxley Act** requires each issuer of securities to disclose whether it has adopted a code of ethics for its senior officers and the contents of that code. This act also requires that financial statements filed with the SEC be certified by the CEO and CFO as fairly representing the company’s financial performance and position. Violators can receive a \$5 million fine and/or up to 20 years in prison. Nevertheless, accounting abuses occur, as the listing below of some recent accounting scandals shows.

Company	Alleged Accounting Abuses
Enron	Inflated income, hid debt, and bribed officials
WorldCom	Understated expenses to inflate income and hid debt
Fannie Mae	Inflated income
Adelphia Communications	Understated expenses to inflate income and hid debt
AOL Time Warner	Inflated revenues and income
Xerox	Inflated income
Bristol-Myers Squibb	Inflated revenues and income
Nortel Networks	Understated expenses to inflate income
Global Crossing	Inflated revenues and income
Tyco	Hid debt, and CEO evaded taxes
Halliburton	Inflated revenues and income
Qwest Communications	Inflated revenues and income



IN THE NEWS

Virtuous Returns Virtue is not always its own reward. Compare the S&P 500 with the Domini Social Index (DSI), which covers 400 companies that have especially good records of social responsibility. We see that returns for companies with socially responsible behavior are at least as high as those of the S&P 500.

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Graphical displays are often used to illustrate key points.

L05 Explain the meaning of generally accepted accounting principles.

Generally Accepted Accounting Principles

Financial accounting practice is governed by concepts and rules known as **generally accepted accounting principles (GAAP)**. To use and interpret financial statements effectively, we need to understand these principles. GAAP aims to make information in financial statements relevant, reliable, and comparable. *Relevant information* affects the decisions of its users. *Reliable information* is trusted by users. *Comparable information* is helpful in contrasting organizations. Appendix B provides a more detailed discussion of generally accepted accounting principles.

L06 Identify the groups that establish generally accepted accounting principles.

Setting Accounting Principles Two main groups establish generally accepted accounting principles in the United States. The **Financial Accounting Standards Board (FASB)** is the private group that sets both broad and specific principles. The **Securities and Exchange Commission (SEC)** is the government group that establishes reporting requirements for companies that issue stock to the public.

In today's global economy, there is increased demand by external users for comparability in accounting reports. This often arises when companies wish to raise money from lenders and investors in different countries. To that end, the **International Accounting Standards Board (IASB)** issues *International Financial Reporting Standards (IFRS)* that identify preferred accounting practices. The IASB hopes to create more harmony among accounting practices of different countries. If standards are harmonized, one company can potentially use a single set of financial statements in all financial markets. Many countries' standard setters support the IASB, and differences between U.S. GAAP and IASB's practices are fading. Yet, the IASB does not have authority to impose its standards on companies.

Rules-Based versus Principles-Based U.S. accounting practices are often viewed as *rules-based*. This means that companies apply technical, specific, and detailed rules in preparing financial statements. A *principles-based* approach is sometimes argued as preferable. A principles-based system would develop and apply broad, fundamental concepts for reporting. Companies would have more flexibility in preparing principles-based reports. For example, a broad principle might be that a company must report all debt it might have to repay. Certain executives of **Enron** were able to mislead investors by not reporting some of its debt. While many of Enron's reports technically followed rules-based standards, the reports failed to adequately disclose its debts.

IN THE NEWS

Principles and Scruples Auditors, directors, and lawyers are using principles to improve accounting reports. Examples include accounting restatements at **Navistar**, financial restatements at **Nortel**, accounting reviews at **Echostar**, and expense adjustments at **Electronic Data Systems**. Principles-based accounting has led accounting firms to drop clients deemed too risky. Examples include **Grant Thornton's** resignation as auditor of **Fremont General** due to alleged failures in providing information when promised, and **Ernst and Young's** resignation as auditor of **Catalina Marketing** due to alleged accounting errors.



HOW YOU DOIN'?

Answers—p. 13

8. What three-step guidelines can help people make ethical decisions?
9. Why are ethics and social responsibility valuable to organizations?
10. Why are ethics crucial in accounting?
11. Who sets U.S. accounting rules?
12. How are U.S. companies affected by international accounting standards?

Ownership Structures

The **business entity assumption** means that a business is accounted for separately from other business and from its owners. This is necessary for making good business decisions. Businesses generally are of one of three major legal forms: *proprietorships*, *partnerships*, and *corporations*. In this book you will learn the accounting for each of these different business types.

LO7 Identify the three types of ownership structures.

1. A **sole proprietorship**, or simply **proprietorship**, is a business owned by one person. No special legal requirements must be met to start a proprietorship. It is a separate entity for accounting purposes, but it is *not* a separate legal entity from its owner. This means, for example, that a court can order an owner to sell personal belongings to pay a proprietorship's debt. This *unlimited liability* of a proprietorship is a disadvantage. However, an advantage is that a proprietorship's income is not subject to a business income tax but is instead reported and taxed on the owner's personal income tax return. Business characteristics are summarized in Exhibit 1.8.

Characteristic	Proprietorship	Partnership	Corporation
Business entity	yes	yes	yes
Legal entity	no	no	yes
Limited liability	no*	no*	yes
Unlimited life	no	no	yes
Business taxed	no	no	yes
One owner allowed	yes	no	yes

Exhibit 1.8

Characteristics of Businesses

* Proprietorships and partnerships that are set up as LLCs provide limited liability.

2. A **partnership** is a business owned by two or more people called *partners*. Like a proprietorship, no special legal requirements must be met in starting a partnership. The only requirement is an agreement between partners to run a business together. The agreement can be either oral or written and usually indicates how income and losses are to be shared. A partnership, like a proprietorship, is *not* legally separate from its owners. This means that each partner's share of profits is reported and taxed on that partner's tax return. It also means *unlimited liability* for its partners. However, several types of partnerships limit liability. The most common of these, a *limited liability company (LLC)*, offers the limited liability of a corporation and the tax treatment of a partnership (and proprietorship).
3. A **corporation** is a business legally separate from its owners, meaning it is responsible for its own acts and its own debts. Separate legal status means that a corporation can conduct business with the rights, duties, and responsibilities of a person. A corporation acts through its managers, who are its legal agents. Separate legal status also means that its owners, who are called **shareholders** (or **stockholders**), are not personally liable for corporate acts and debts. This limited liability is its main advantage. A main disadvantage is what's called *double taxation*—meaning that (1) the corporation's income is taxed and (2) any distribution of income to the corporation's owners through dividends is taxed as part of the owners' personal income.

Types of Businesses Businesses can also be classified by the type of product or service they provide. A **service business** provides services to customers. These could include computer

repair, catering, tax preparation, and many others. A **merchandising business** buys products from other companies and then resells them to consumers. **Best Buy**, **RadioShack**, and **Target** are well-known merchandisers. **Manufacturing businesses**, like **LoveSac**, make products to sell to either merchandisers and/or consumers. We will study the accounting for each of these business types in this book.

HOW YOU DOIN'?

Answers—p. 13

13. Why is the business entity assumption important?
14. What are the three basic forms of business organization?
15. What is the name given the owners of a corporation? What is the name given to the ownership units of a corporation?

The Demonstration Problem is a review of key chapter content. Planning the Solution offers strategies in solving the problem.

Demonstration Problem

After months of planning, Polly Guthrie opens SuperSub, a sandwich shop. Because this is her first time running a business, Polly is wondering who will use her financial statements.

Required

List four potential external or internal users of SuperSub's financial statements. Explain how they might use these statements.

Planning the Solution

- Look back at the list of possible external and internal users on pages 5 and 6 and think about how each might use SuperSub's financial statements.
- Consider any user that might use and need SuperSub's financial statements.

Solution to Demonstration Problem

Interested users would include:

1. Polly Guthrie, owner and internal user. Polly will use the financial statements to see where she is earning and spending her money. She can also use her financial statements to predict and budget for future sales and costs.
2. Internal Revenue Service, external user. This regulator will need to see SuperSub's accounting reports to compute and monitor the accurate payment of income tax.
3. Lenders (or a bank), external user. Owners periodically need loans to operate or expand their businesses. The bank often requests financial statements, which it can use to assess whether SuperSub will be able to repay its loans.
4. Suppliers (creditors), external user. Suppliers of the foodstuffs like assurance that they will get paid promptly. They will often ask for financial statements or additional financial information to get the information they need.

← A Summary organized by learning objectives concludes each chapter.

Summary

L01 Explain the purpose and importance of accounting in the information age. Accounting is an information and measurement system that aims to identify, record, and communicate relevant, reliable, and comparable information about business activities. It helps assess opportunities, products, investments, and social and community responsibilities.

L02 Identify users and uses of accounting. Users of accounting are both internal and external. Some users and uses of accounting include (a) managers in controlling, monitoring, and planning; (b) lenders for measuring the risk and repayment of loans; (c) shareholders for assessing the return and risk of stock; (d) directors for overseeing management; and (e) employees for judging employment opportunities.

L03 Identify career opportunities in accounting and related fields. Opportunities in accounting include financial, managerial, and tax accounting. They also include accounting-related fields such as lending, consulting, managing, and planning.

L04 Explain why ethics are crucial to accounting. The goal of accounting is to provide useful information for decision making. For information to be useful, it must be trusted. This demands ethical behavior in accounting.

L05 Explain the meaning of generally accepted accounting principles. Generally accepted accounting principles are a common set of standards applied by accountants. Accounting principles aid in producing relevant, reliable, and comparable information.

L06 Identify the groups that establish generally accepted accounting principles. Generally accepted accounting principles (GAAP) are established by two main groups in the United States: the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC). The FASB is a private entity that sets financial accounting principles. The SEC is the governmental entity that establishes financial reporting requirements for companies that issue stock to the public.

L07 Identify the three types of ownership structures.

Proprietorships, partnerships, and corporations are the three main types of ownership structures. A proprietorship is a business owned by one person, while a partnership is owned by two or more partners. Proprietorships and partnerships are not separate legal entities from their owners. Corporations are separate legal entities from their owners, who are called shareholders.

Guidance Answers to

HOW YOU DOIN'?

- Accounting is an information and measurement system that identifies, records, and communicates relevant information to help people make better decisions.
- Recordkeeping, also called *bookkeeping*, is the recording of financial transactions and events, either manually or electronically. Recordkeeping is essential to data reliability; but accounting is this and much more. Accounting includes identifying, measuring, recording, reporting, and analyzing business events and transactions.
- External users of accounting include lenders, shareholders, directors, customers, suppliers, regulators, lawyers, brokers, and the press. Internal users of accounting include managers, officers, and other internal decision makers involved with strategic and operating decisions.
- Internal users (managers) include those from research and development, purchasing, human resources, production, distribution, marketing, and servicing.
- Internal controls are procedures designed to protect assets, ensure reliable accounting reports, promote efficiency, and encourage adherence to company policies. Internal controls are crucial for relevant and reliable information.
- Tax preparation, tax planning, and tax enforcement are among the various career opportunities in the taxation area.
- Some of the certificates that exist in accounting include: certified public accountant (CPA), certified management accountant (CMA), certified internal auditor (CIA), certified fraud examiner (CFE), certified bookkeeper (CB), certified payroll professional (CPP), and personal financial specialist (PFS).
- Ethical guidelines are threefold: (1) identify ethical concerns using personal ethics, (2) analyze options considering all good and bad consequences, and (3) make ethical decisions after weighing all consequences.
- Ethics and social responsibility yield good behavior, and they often result in higher income and a better working environment.
- For accounting to provide useful information for decisions, it must be trusted. Trust requires ethics in accounting.
- Two major participants in setting rules include the SEC and the FASB.
- Most U.S. companies are not directly affected by international accounting standards. International standards are put forth as preferred accounting practices. However, stock exchanges and other parties are increasing the pressure to narrow differences in worldwide accounting practices. International accounting standards are playing an important role in that process.
- Users desire information about the performance of a specific entity. If information is mixed between two or more entities, its usefulness decreases.
- The three basic forms of business organization are sole proprietorships, partnerships, and corporations.
- Owners of corporations are called *shareholders* (or *stockholders*). Corporate ownership is divided into units called *shares* (or *stock*). The most basic of corporate shares is common stock (or capital stock).

← A list of key terms with page references concludes each chapter (a complete glossary is at the end of the book).

Key Terms

Accounting (p. 4) Information and measurement system that identifies, records, and communicates relevant information about a company's business activities.

Business entity assumption (p. 11) Concept that assumes a business will be accounted for separately from its owner(s) and any other entity.

Corporation (p. 11) Business that is a separate legal entity under state or federal laws with owners called *shareholder* or *stockholders*.

Ethics (p. 9) Codes of conduct by which actions are judged as right or wrong, fair or unfair, honest or dishonest.

External users (p. 6) Persons using accounting information who are not directly involved in running the organization.

Financial accounting (p. 6) Area of accounting mainly aimed at serving external users.

Financial Accounting Standards Board (FASB) (p. 10) Independent group of full-time members responsible for setting accounting rules.

Generally accepted accounting principles (GAAP) (p. 10) Rules that specify acceptable accounting principles.

Internal users (p. 5) Persons using accounting information who are directly involved in managing the organization.

International Accounting Standards Board (IASB) (p. 10) Group that identifies preferred accounting practices and encourages global acceptance; issues International Financial Reporting Standards (IFRS).

Managerial accounting (p. 5) Area of accounting mainly aimed at serving the decision-making needs of internal users; also called *management accounting*.

Manufacturing business (p. 12) A business that makes products for sale.

Merchandising business (p. 12) A business that buys goods from manufacturers and then sells them to consumers.

Partnership (p. 11) Unincorporated association of two or more persons to pursue a business for profit as co-owners.

Proprietorship (p. 10) Business owned by one person that is not organized as a corporation.

Recordkeeping (p. 4) Part of accounting that involves recording transactions and events, either manually or electronically; also called *bookkeeping*.

Sarbanes-Oxley Act (p. 9) Created the *Public Company Accounting Oversight Board*, regulates analyst conflicts, imposes corporate governance requirements, enhances accounting and control disclosures, impacts insider transactions and executive loans, establishes new types of criminal conduct, and expands penalties for violations of federal securities laws.

Securities and Exchange Commission (SEC) (p. 10) Federal agency Congress has charged to set reporting rules for organizations that sell ownership shares to the public.

Service business (p. 11) A business that provides services to customers.

Shareholders (p. 11) Owners of a corporation; also called *stockholders*.

Multiple Choice Quiz

Answers on p. 19

mhhe.com/wildCA2e

Additional Multiple Choice Quizzes are available at the book's Website.

- Accounting is an information and measurement system that _____ information about an organization's business activities.
 - Translates
 - Records
 - Chooses
 - Prints out
- External users of financial information include:
 - Purchasing managers
 - Service managers
 - The chief executive officer
 - Lenders
- Typical accounting specialists with designations include all of the following except:
 - Certified Financial Analyst (CFA)
 - Certified Public Accountant (CPA)
 - Certified Bookkeeper (CB)
 - Certified Payroll Professional (CPP)
- Generally accepted accounting principles do not aim to make information in financial statements:
 - Reasonable
 - Relevant
 - Reliable
 - Comparable
- The Financial Accounting Standards Board is the:
 - Governmental group that sets financial accounting principles.
 - International group that identifies preferred international accounting principles.
 - Private group that sets both broad and specific accounting principles.
 - Governmental group that sets standards for state and local governmental financial statements.

Discussion Questions

- What is the purpose of accounting in society?
- Technology is increasingly used to process accounting data. Why then must we study and understand accounting?
- Identify at least four kinds of external users and describe how they use accounting information.
- What are at least three questions business owners and managers might be able to answer by looking at accounting information?
- Identify three actual businesses that offer services and three actual businesses that offer products.
- Describe the internal role of accounting for organizations.

- 7. Identify three types of services typically offered by accounting professionals.
- 8. What type of accounting information might be useful to the marketing managers of a business?
- 9. Why is accounting described as a service activity?
- 10. What are some accounting-related professions?
- 11. How do ethics rules affect auditors' choice of clients?
- 12. What work do tax accounting professionals perform in addition to preparing tax returns?
- 13. Refer to the financial statements of **Best Buy** in Appendix A near the end of the book. Look at the consolidated statements of earnings (income statement). How many years are included and what are their dates?



Connect Accounting repeats assignments via the Web, which allows instructors to monitor, promote, and assess student learning. It can be used in practice, homework, or exam mode.

Quick Study exercises give readers a brief test of key elements.

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(a) Define these accounting-related acronyms: GAAP, SEC, FASB and IASB. (b) Briefly explain the importance of the knowledge base or organization that is referred to for each of the accounting-related acronyms.

QUICK STUDY

QS 1-1
Identifying accounting terms
L05 L06

Identify the following users as either external users (E) or internal users (I).

- a. Customers
- b. Suppliers
- c. Brokers
- d. Business press
- e. Managers
- f. District attorney
- g. Shareholders
- h. Lenders
- i. Controllers
- j. FBI and IRS
- k. Consumer group
- l. Sales staff

QS 1-2
Identifying accounting users **L02**

An important responsibility of many accounting professionals is to design and implement internal control procedures for organizations. Explain the purpose of internal control procedures. Provide two examples of internal controls applied by companies.

QS 1-3
Explaining internal control **L02**

Identify at least three main areas of opportunities for accounting professionals. For each area, identify at least three job possibilities linked to accounting.

QS 1-4
Accounting opportunities **L03**

Accounting professionals must sometimes choose between two or more acceptable methods of accounting for business transactions and events. Explain why these situations can involve difficult matters of ethical concern.

QS 1-5
Identifying ethical concerns **L04**

Using the information provided in the chapter, determine what the 2012 estimate of salaries is for the following selected accounting fields:

QS 1-6
Identifying career opportunities
L03

Accounting Position	Expected 2012 Salary
Controller/treasurer	\$?
Private accounting (senior)	\$?
Payroll manager	\$?
Public accounting (manager)	\$?

QS 1-7

Generally accepted accounting principles **L05**

Generally accepted accounting principles aim to make information relevant, reliable, and comparable. Choose the correct definition on the right for each of these terms:

- | | |
|----------------------|---------------------------------------------------------------|
| 1. Relevant | a. Information is both broad and specific |
| 2. Reliable | b. Information is helpful in contrasting organizations |
| 3. Comparable | c. The information affects the decisions of its users. |
| | d. Information is trusted by users |

QS 1-8

Ownership structures **L07**

Businesses generally are of three major legal forms. List and briefly describe these three alternative legal forms of business ownership structure.

EXERCISES**Exercise 1-1**

Describing accounting responsibilities **L02 L03**

Many accounting professionals work in one of the following three areas.

A. Financial accounting **B.** Managerial accounting **C.** Tax accounting

Identify the area of accounting that is most involved in each of the following responsibilities.

- | | |
|------------------------------------|----------------------------------------------------------|
| _____ 1. Internal auditing. | _____ 5. Investigating violations of tax laws. |
| _____ 2. External auditing. | _____ 6. Planning transactions to minimize taxes. |
| _____ 3. Cost accounting. | _____ 7. Preparing external financial statements. |
| _____ 4. Budgeting. | _____ 8. Reviewing reports for SEC compliance. |

Exercise 1-2

Identifying accounting users and uses **L02**

Much of accounting is directed at serving the information needs of those users that are external to an organization. Identify at least three external users of accounting information and indicate two questions they might seek to answer through their use of accounting information.

Exercise 1-3

Identifying ethical concerns **L04**

Assume the following roles and describe a situation in which ethical considerations play an important part in guiding your decisions and actions.

- You are a student in an introductory accounting course.
- You are a manager with responsibility for several employees.
- You are an accounting professional preparing tax returns for clients.
- You are an accounting professional with audit clients that are competitors in business.

Exercise 1-4

Learning the language of business **L03 L04 L05 L06**

Match each of the numbered descriptions 1 through 7 with the term or phrase it best reflects. Indicate your answer by writing the letter for the term or phrase in the blank provided.

- | | | | |
|-----------------|--------------------------|------------------------------|----------------|
| A. Audit | C. Ethics | E. SEC | G. IASB |
| B. GAAP | D. Tax accounting | F. Public accountants | |
- Principles that determine whether an action is right or wrong.
 - Accounting professionals who provide services to many clients.
 - An accounting area that includes planning future transactions to minimize taxes paid.
 - An examination of an organization's accounting system and records that adds credibility to financial statements.
 - Government group that establishes reporting requirements for companies that issue stock to the public.
 - Concepts and rules that govern financial accounting practice.
 - Group that issues preferred international accounting practices.

Exercise 1-5

Ownership structures **L07**

Following are descriptions of several different business organizations. Determine whether the description refers to a sole proprietorship, partnership, or corporation.

- Ownership of Zander Company is divided into 1,000 shares of stock.
- Wallingford is owned by Trent Malone, who is personally liable for the company's debts.

- c. Elijah Fong and Ava Logan own Financial Services, a financial services provider. Neither Fong nor Logan has personal responsibility for the debts of Financial Services.
- d. Dylan Bailey and Emma Kayley own Speedy Packages, a courier service. Both are personally liable for the debts of the business.
- e. IBC Services does not have separate legal existence apart from the one person who owns it.
- f. Physio Products does not pay income taxes and has one owner.
- g. Aaliyah Services pays its own income taxes and has two owners.

Accounting specialists are often denoted by certifications. Several of these are mentioned in the chapter. Write the full name of each of the certifications below:

- a. CMA
- b. CPA
- c. CFE
- d. CB
- e. PFS
- f. CIA
- g. CPP

Exercise 1-6

Professional certifications L03

connect

The following is a list of selected users of accounting information. Match the appropriate user A through E to the following information needs 1 through 5.

- A. Suppliers
- B. Lenders
- C. Shareholders
- D. Production managers
- E. Employees

- _____ 1. Monitor costs and ensure quality.
- _____ 2. Judge the soundness of a customer before making sales on credit.
- _____ 3. Assessing employment opportunities.
- _____ 4. Assessing whether a loan is likely to be repaid.
- _____ 5. Deciding whether to buy, hold, or sell stock.

PROBLEM SET A**Problem 1-1A**

Identifying accounting users L02

The following is a list of broad opportunities in accounting. Match the appropriate broad opportunity A through D to the specific accounting opportunity 1 through 8.

- A. Financial
- B. Managerial
- C. Taxation
- D. Accounting-related

- _____ 1. Appraiser
- _____ 2. Estate planning
- _____ 3. External audit
- _____ 4. Budgeting
- _____ 5. Litigation support
- _____ 6. Internal audit
- _____ 7. Financial statement preparation
- _____ 8. Tax planning

Problem 1-2A

Identify opportunities in accounting L03

The following is a list of selected internal users of accounting information. Match the appropriate user A through E to the following information needs 1 through 5.

- A. Research and development managers
- B. Human resource managers
- C. Distribution managers
- D. Purchasing managers
- E. Service managers

- _____ 1. Assessing when and how much to purchase.
- _____ 2. Judge the costs and benefits of looking after products and services.
- _____ 3. Monitor timely, accurate, and efficient delivery of products and services.
- _____ 4. Assessing employees' payroll, benefits, performance, and compensation.
- _____ 5. Measuring projected costs and revenues of any proposed changes in products and services.

PROBLEM SET B**Problem 1-1 B**

Identifying accounting users L02

The following is a list of accounting terms. Match the appropriate accounting term A through D to its definition 1 through 4.

- A. Accounting
- B. Bookkeeping
- C. Managerial accounting
- D. Financial accounting

Problem 1-2B

Definition of accounting terms L01 L02

- _____ 1. Area of accounting aimed at serving external users by providing them with financial statements.
- _____ 2. Information and measurement system that identifies, records, and communicates information about an organization's business activities.
- _____ 3. The recording of transactions and events, either manually or electronically.
- _____ 4. Area of accounting that serves the decision-making needs of internal users.

The serial problem starts in this chapter and continues throughout most chapters of the book. It is most readily solved if you use the Working Papers that accompany this book.

SERIAL PROBLEM

Success Systems

SP 1 On October 1, 2010, Adriana Lopez launched a computer services company, **Success Systems**, that is organized as a proprietorship and provides consulting services, computer system installations, and custom program development. Lopez will prepare the company's first set of financial statements on December 31, 2010.

Required

List at least five potential internal and external users of Success Systems' financial statements. Explain why each user would be interested in the financial statements.

Beyond the Numbers (BTN) is a special problem section aimed to refine communication, conceptual, analysis, and research skills. It includes many activities helpful in developing an active learning environment.

BEYOND THE NUMBERS

REPORTING IN ACTION

L01



BTN 1-1 Find **Best Buy's** annual report included in Appendix A near the end of the book.

Required

List at least three likely users of Best Buy's financial statements and how they would use financial statements.

ETHICS CHALLENGE

L04

BTN 1-2 Managerial accounting professionals follow a code of ethics. As a member of the Institute of Management Accountants, the managerial accountant must comply with Standards of Ethical Conduct.

Required

1. Identify, print, and read the *Statement of Ethical Professional Practice* posted at www.ima.org. (Search using "ethical professional practice.")
2. What four overarching ethical principles underlie the IMA's statement?
3. Describe the courses of action the IMA recommends in resolving ethical conflicts.

WORKPLACE COMMUNICATION

L06

BTN 1-3 The Financial Accounting Standards Board (FASB) sets accounting standards. The FASB's mission is described at its Website (FASB.org) under the tab "About FASB."

Required

Prepare a half-page report outlining the mission of the FASB. Identify the ways it has set out to accomplish that mission.

TAKING IT TO THE NET

L02

BTN 1-4 Find **Best Buy's** most current financial statements by going to their Website (BestBuy.com) and click on the link "For Our Investors" at the bottom of the page. Click on "Annual Reports" in the right column. Click on the most recent "Form 10-K" tab.

Required

1. What is the date of this annual report?
2. What are the titles of the financial statements included in this report?

BTN 1-5 Teamwork is important in today's business world. Successful teams schedule convenient meetings, maintain regular communications, and cooperate with and support their members. This assignment aims to establish support/learning teams, initiate discussions, and set meeting times.

TEAMWORK IN ACTION**L01****Required**

1. Form teams and open a team discussion to determine a regular time and place for your team to meet between each scheduled class meeting. Notify your instructor via a memorandum or e-mail message as to when and where your team will hold regularly scheduled meetings.
2. Develop a list of telephone numbers and/or e-mail addresses of your teammates.

BTN 1-6 Refer to this chapter's opening feature about **LoveSac**. Assume that Shawn Nelson decides to open a new manufacturing facility to meet customer demand. To open the new facility, Shawn would have to get a loan from a bank.

ENTREPRENEURS IN BUSINESS**L02****Required**

1. Which external users would be interested in reviewing LoveSac's financial statements? Why?
2. What specific information would a loan officer want to review before extending a loan to LoveSac?

BTN 1-7 You and a friend develop a new design for in-line skates that improves speed and performance by 25 to 40 percent. You plan to form a business to manufacture and market these skates. You and your friend want to minimize taxes, but your prime concern is potential lawsuits from individuals who might be injured on these skates. What form of organization do you set up?

YOU CALL IT — ENTREPRENEUR

1. b
2. d
3. a

4. a
5. c

ANSWERS TO MULTIPLE CHOICE QUIZ