Section 1: What Is Accounting?

Section Objectives

1. Define accounting.

2. Identify and discuss career opportunities in accounting.

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?
- What is the cost of the merchandise sold?
- What is the change in sales volume?
- How much money is owed suppliers?
- What is the profit or loss?
QUESTION:

What is accounting?

ANSWER:

Accounting is the process by which financial information about a business is recorded, classified, 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 or operating results.
Many jobs are available in the accounting profession. Some examples are:

- **Accounting Clerk**
- **Bookkeeper**
- **Accountant**
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:

What 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.
QUESTION:

What is managerial accounting?

ANSWER:

Managerial accounting is accounting 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
- Providing 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 is accounting work performed 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
Objective 3

Inside The Business
- Owners
- Managers
- Employees

Outside The Business
- Tax Authorities
- Suppliers
- Regulatory Agencies
- Unions
- Banks
- Customers
- Investors and Potential Investors

Identify the users of financial information
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 to 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 profit-sharing plans
Section Objectives

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

5. Describe the process used to develop generally accepted accounting principles.
Objective 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.
<table>
<thead>
<tr>
<th>Ownership</th>
<th>Sole Proprietorship</th>
<th>Partnership</th>
<th>Corporation</th>
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<tbody>
<tr>
<td>Ownership</td>
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<td>Responsibility for business debts if firm is unable to pay</td>
<td>Owner</td>
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</table>
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.
<table>
<thead>
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<tbody>
<tr>
<td>Ownership</td>
<td>1 owner</td>
<td>2 or more</td>
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<td>Life</td>
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<td>• closes the firm</td>
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<tr>
<td>Responsibility</td>
<td>Owner</td>
<td>Partners</td>
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<td>debts if firm is</td>
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<td>and jointly</td>
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<td>unable to pay</td>
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</table>
Typical partnerships

Professional services such as:

Medical Practices

Accounting Firms

Dental Practices

Architectural Firms

Law Firms
Partners must agree upon:

• Amount each partner will contribute.
• 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.
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.
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<td>2 or more</td>
<td>Can be thousands</td>
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<tr>
<td>Life</td>
<td>Ends when owner:</td>
<td>Ends when</td>
<td>Continues indefinitely; ends</td>
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<td>• is unable to</td>
<td>partner(s):</td>
<td>when:</td>
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<td></td>
<td>carry on,</td>
<td>• dies,</td>
<td>• business goes bankrupt</td>
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<td></td>
<td>• dies, or</td>
<td>• close the firm</td>
<td>• stockholders vote to</td>
</tr>
<tr>
<td></td>
<td>• closes the firm</td>
<td>• withdraws</td>
<td>liquidate</td>
</tr>
<tr>
<td>Responsibility for business debts if firm is unable to pay</td>
<td>Owner</td>
<td>Partners individually and jointly</td>
<td>Stockholders can lose only the amount invested</td>
</tr>
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QUESTION:

What is stock?

ANSWER:

Stock is issued in the form of stock certificates and represents 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.
QUESTION:

What are generally accepted accounting principles (GAAP)?

ANSWER:

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

Has final say

SEC

Delegates to...

Develops GAAP

FASB

Governmental Agency

Accounting Profession
QUESTION:

What is an auditor’s report?

ANSWER:

An auditor’s report is an independent accountant’s review of a firm’s financial statements.
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