

CHAPTER 1

INTRODUCTION TO ACCOUNTING

REVIEW QUESTIONS

1. The purpose of accounting is to provide financial information about a business to individuals and organizations.
2. Four user groups normally interested in financial information about a business are owners, managers, creditors, and government agencies.
3. The six major steps of the accounting process are listed below.
 - a. Analyzing is looking at events that have taken place and thinking about how these affect the business. This first step in the accounting process usually occurs when the business receives some type of information, such as a bill, that needs to be properly entered into the business's records. This first step also involves deciding if the piece of information should result in an accounting entry or not.
 - b. Recording is entering financial information into the accounting system.
 - c. Classifying is sorting and grouping like items together.
 - d. Summarizing is the aggregation of many similar events to provide information that is easy to understand.
 - e. Reporting is telling the results.
 - f. Interpreting is deciding the importance of information in the various reports.
4. Generally accepted accounting principles (GAAP) are the rules that businesses must follow when preparing financial statements.
5. FASB takes the following steps to develop an accounting standard:
 1. The issue is placed on the Board's agenda.
 2. After researching the issue, a Preliminary Views document is issued.
 3. Public hearings are held.
 4. An Exposure Draft is issued.
 5. An Accounting Standards Update is issued which amends the FASB Accounting Standards Codification.
6. The International Accounting Standards Board.
7. The three types of ownership structures are listed below.
 - a. A sole proprietorship is owned by one person. The owner assumes all risks for the business. The advantage is that the owner can make all of the business decisions.
 - b. A partnership is owned by more than one person. Partners assume the risks for the business, and their assets may be taken to pay creditors. An advantage of a partnership is that owners share risks and decision making. A disadvantage is that partners may disagree about the best way to run the business.
 - c. A corporation is owned by stockholders. The owners' risk is usually limited to their initial investment, but they typically have very little influence on business decisions.
8. Three types of businesses classified by activities are service businesses, merchandising businesses, and manufacturing businesses.
9. An accounting clerk performs accounting tasks such as recording, sorting, and filing accounting information.

10. Four areas of specialization for a public accountant are auditing, taxation, management advisory services, and forensic accounting.

Auditing—Auditing involves the application of standard review and testing procedures to be certain that proper accounting policies and practices have been followed. The purpose of the audit is to provide an independent opinion that the financial information about a business is fairly presented.

Taxation—The work of tax specialists includes offering advice on tax planning, preparing tax returns, and representing clients before governmental agencies, such as the Internal Revenue Service.

Management Advisory Services—Given the financial training and business experience of public accountants, many businesses seek their advice on a wide variety of managerial issues.

Forensic Accounting—Forensic accounting is a specialized field that combines fraud detection, fraud prevention, litigation support, expert witnessing, business valuations, and other investigative activities.

11. The Sarbanes-Oxley Act (SOX) was passed by Congress to help improve reporting practices of public companies. One important provision prohibits accounting firms from providing audit and management advisory services to the same company.

12. Six areas of specialization for a managerial accountant are accounting information systems, financial accounting, cost accounting, budgeting, tax accounting, and internal auditing.

Accounting Information Systems—Accountants in this area design and implement manual and computerized accounting systems.

Financial Accounting—Based on the accounting data prepared by the bookkeepers and accounting clerks, the accountant prepares various reports and financial statements.

Cost Accounting—The cost of producing specific products or providing services must be measured. Further analysis is also done to determine whether the products and services are produced in the most cost-effective manner.

Budgeting—In the budgeting process, accountants help management develop a financial plan for the future.

Tax Accounting—A firm may have its own accountants to focus on tax planning, preparation of tax returns, and dealing with the Internal Revenue Service and other governmental agencies.

Internal Auditing—The main functions of an internal auditor are to review the operating and accounting control procedures adopted by management and to see that accurate and timely information is provided.

Exercise 1-1A

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|----|-------------------------|---------------------|----|---|
| 1. | <u> d </u> | Owners | a. | Whether the firm can pay its bills on time |
| 2. | <u> b </u> | Managers | b. | Detailed, up-to-date information to measure business performance (and plan for future operations) |
| 3. | <u> a </u> | Creditors | c. | To determine taxes to be paid and whether other regulations are met |
| 4. | <u> c </u> | Government agencies | d. | The firm's current financial condition |

Exercise 1-2A

<u>Order</u>	<u>Accounting Process</u>	<u>Definition</u>
<u> 2 </u>	Recording	<i>entering financial information into the accounting system</i>
<u> 4 </u>	Summarizing	<i>aggregating many similar events to provide information that is easy to understand</i>
<u> 5 </u>	Reporting	<i>telling the results</i>
<u> 1 </u>	Analyzing	<i>looking to see what events have taken place and thinking about how these affect the business</i>
<u> 6 </u>	Interpreting	<i>deciding the importance of information on the various reports</i>
<u> 3 </u>	Classifying	<i>sorting and grouping like items together</i>

Exercise 1-1B

<u>Users</u>	<u>Information</u>
Owners (present and future):	<u><i>firm's profitability and current financial condition</i></u>
Managers:	<u><i>detailed, up-to-date information about the business to measure performance</i></u>
Creditors (present and future):	<u><i>firm's profitability, debt outstanding, and assets that could be used to secure debt</i></u>
Government agencies:	<u><i>firm's profitability, cash flows, and overall financial condition</i></u>

Exercise 1-2B

<u>Letter</u>	<u>Accounting Process</u>	<u>Definition</u>
<u><i>b</i></u>	Analyzing	a. Telling the results
<u><i>f</i></u>	Recording	b. Looking at events that have taken place and thinking about how they affect the business
<u><i>e</i></u>	Classifying	c. Deciding the importance of the various reports
<u><i>d</i></u>	Summarizing	d. Aggregating many similar events to provide information that is easy to understand
<u><i>a</i></u>	Reporting	e. Sorting and grouping like items together
<u><i>c</i></u>	Interpreting	f. Entering financial information into the accounting system

MANAGING YOUR WRITING

The purpose of this writing assignment is to give the students an opportunity to dream about the type of business they might enjoy. In the current economy, most opportunities are with smaller, start-up companies. The students should demonstrate an understanding of the different forms of ownership and describe the advantages and disadvantages of each form. Further, they should demonstrate an understanding of the different types of businesses: service, merchandising, and manufacturing.