**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.

**Chapter Opener: Thinking Critically**

“At the beginning of the chapter, there is a short article about *Uber*. Let’s read this together.”

**Ask students**, “Can you think of any organizations that would be interested in how *Uber* is performing?”

**Answer---** **Stockholders, the IRS, SEC, banks, lenders and creditors are all examples of organizations that would be interested in how *Uber* is performing.**

**Ask students**, “Do any of you have checking accounts?” Have students compare the check writing process to the accounting process.

**Section 1. WHAT IS ACCOUNTING?**

**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**

**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**
* 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).
* **Public Accounting—**Careers in public accounting include auditing, tax accounting, and management advisory services.
* 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**

**Accounting Careers:**

**Ask students**, questions like “Why should we study accounting?” or “Why are you here?”

* 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**

**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—** TheIRS, 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 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.

**Section 2. BUSINESS AND ACCOUNTING**

**Objective 1-4**

**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 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/she have to keep? (Answer=4, one for each business and one for his/her personal records.)

**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.

**Managerial Implications:**

**Ask students**, “If you were a manager, how would you use financial information to make decisions?

**Answers will vary but could include the following**:  
Managers use financial information to make decisions about adding new products and services, offering current products and services, and choosing vendors.