

1 ***ACCOUNTING: INFORMATION FOR DECISION MAKING***

Chapter Summary

Our financial reporting system has changed greatly over the past 50 years and will continue to change. The financial world is experiencing unparalleled challenges, such as globalization, deregulation, and the widespread use of the World Wide Web. In the midst of these changes is the accounting profession that must provide reliable and relevant information to users. This chapter introduces accounting to the student as the means of providing the information to support such decisions. Two broad types of accounting information, financial and internal are introduced and discussed. The production and communication of information within an accounting system is introduced at the outset of the chapter.

The focus then shifts to the various consumers of accounting information and the uses to which they put that information. External users are discussed first with the natural emphasis placed on the decision-making needs of investors and creditors. The needs of these users are summarized in terms of their interest in cash flow prospects. The financial accounting process communicates these prospects. The objectives of the reporting process are discussed in some detail leading to a definitional listing of the financial statements. This segment of the chapter concludes with an overview of the characteristics of externally reported accounting information.

The orientation of the chapter now shifts to decision-making by parties internal to an organization and how internal accounting supports these decisions. Internal users are very broadly defined as all employees of the organization. Employees are supported by the internal accounting information system in three ways. First, the internal accounting system assigns decision-making authority over the organization's resources to employees. Second, the internal accounting system provides the information required to make decisions regarding these resources. Finally, employee performance is regularly evaluated and rewarded based on information supplied by the internal accounting system. The characteristics of internal accounting information are discussed at length. This discussion makes the student aware of the distinctions between financial and internal accounting.

The main body of the chapter closes with a discussion of the sources of integrity of accounting information. We introduce institutional features that contribute to the integrity of the information including, accounting principles and standards, systems of internal control, and audits of financial information. The roles played by organizations such as the AICPA, IMA, IIA, AAA, and COSO are discussed. We close by emphasizing the critical importance of the competence, judgment, and ethical behavior of professional accountants.

The chapter begins with an overview of career opportunities offered by the accounting profession. Opportunities in public, management, and government accounting are surveyed, as are career paths in education. We take this opportunity to distinguish between accounting and bookkeeping and to explain the minimal role played by bookkeeping activities.

Learning Objectives

1. Discuss accounting as the language of business and the role of accounting information in making economic decisions.
2. Discuss the significance of accounting systems in generating reliable accounting information and understand the five components of internal control per COSO's *Internal Control-Integrated Framework*.
3. Explain the importance of financial accounting information for external parties – primarily investors and creditors – in terms of the objectives and the characteristics of that information.
4. Explain the importance of accounting information for internal parties – primarily management – in terms of the objectives and the characteristics of that information.
5. Discuss elements of the system of external and internal financial reporting that create integrity in the reported information.
6. Identify and discuss several professional accounting organizations that play important roles in preparing and communicating accounting information.
7. Discuss the importance of personal competence, professional judgment, and ethical behavior on the part of accounting professionals.
8. Describe various career opportunities in accounting.

Brief Topical Outline

- A Accounting information: a means to an end
 - 1 Accounting from a user's perspective
 - 2 Types of accounting information
 - a Financial accounting – see *Case in Point* (page 5)
 - b Management accounting
 - c Tax accounting
- B Accounting systems
 - 1 Determining information needs
 - 2 The cost of producing accounting information
 - 3 Basic functions of an accounting system
 - 4 Who designs and installs accounting systems?
 - 5 Components of internal control
- C Financial accounting information
 - 1 External users of accounting information
 - 2 Objectives of external financial reporting
 - 3 Characteristics of externally reported information - see *Your Turn* (page 10)

- a** Financial reporting-a means
 - b** Financial reporting versus financial statements
 - c** Historical in nature
 - d** Inexact and approximate measures
 - e** General-purpose assumption
 - f** Usefulness enhanced via explanation
 - D** Management accounting information
 - 1** Users of internal accounting information – see Exhibit 1-5
 - 2** Objectives of management accounting information
 - 3** Characteristics of management accounting information
 - a** Importance of timeliness
 - b** Identity of decision maker
 - c** Oriented toward the future
 - d** Measures of efficiency and effectiveness
 - e** Management accounting information - a means
 - E** Integrity of accounting information
 - 1** Institutional features
 - a** Standards for the preparation of accounting information
 - b** Securities and Exchange Commission
 - c** Financial Accounting Standards Board
 - d** International Accounting Standards Board-see *Case in Point* (page **19**)
 - e** Public Company Accounting Oversight Board
 - f** Audits of financial statements
 - g** Legislation
 - 2** Professional organizations – AICPA, IMA, IIA, AAA, COSO
 - 3** Competence, judgment, and ethical behavior – see *Ethics, Fraud & Corporate Governance* (page **26**), Exhibit 1-6 (page **23**) and Your Turn (page **22**)
 - F** Careers in accounting
 - 1** Public accounting
 - a** The CPA examination
 - 2** Management accounting
 - 3** Governmental accounting
 - a** The GAO
 - b** The IRS
 - c** The SEC
 - 4** Accounting education
 - 5** What about bookkeeping?
 - 6** Accounting as a stepping-stone – see *Ethics, Fraud & Corporate Governance* (page **26**)
 - 7** What about me? I'm not an accounting major
 - G** Concluding remarks

Topical Coverage and Suggested assignment

		Homework Assignment (To Be Completed Prior to Class)				
Class Meetings On Chapter	Topical Outline Coverage	Discussion Questions	Brief Exercises	Exercises	Problems	Critical Thinking Cases
1	A - C	1, 2, 4	1, 3	1, 3, 4	n.a.	2
2	D - G	5, 9, 15	5, 6, 7, 8	7, 8, 9, 12	n.a.	4

Comments and Observations

Teaching objectives for Chapter 1

Chapter 1 introduces students to the users of accounting information, both external and internal to the organization. The objectives and characteristics of externally reported and internal accounting information are explained and contrasted with one another. The sources of integrity of accounting information are explained. Career opportunities in accounting are also discussed. In the class meetings relating to this introductory chapter our primary teaching objectives are to:

- 1 Explain the nature and requirements of the course.
- 2 Impress upon students the importance of keeping up with the coursework and completing homework assignments on a timely basis. Impress upon students that accounting is a cumulative knowledge subject. Students lost in Chapter 1 will likely have trouble the rest of the semester.
- 3 Describe the general purpose of accounting and various uses of accounting information. Explain the focus of this course relative to other accounting courses.
- 4 Provide an overview of external financial reporting.
- 5 Explain the nature of internal accounting and the information needs of internal users of accounting information.
- 6 Discuss the factors responsible for assuring the integrity of accounting information.
- 7 Briefly describe some career opportunities in accounting and explain why an understanding of accounting is useful to people other than professional accountants.

General Comments

Getting started During the first class meeting, we find it worthwhile to spend a few minutes acquainting the students with the textbook and its supplements, and explaining the nature of an accounting course. For example, we show students that the text contains check figures to the problems on the inside cover, and that a glossary of key terms, a self-test, and usually a Demonstration Problem (with solution) appear at the end of each chapter.

We give a brief demonstration of the proper use of columnar paper and explain that all homework problems should be prepared in pencil. If the partially filled-in working papers are used (which we recommend), we show the students the worksheet for an extensive problem so that they will appreciate the time savings inherent in this supplement. We also mention that all two-page foldout work sheets are located at the **back of the working paper booklet**. We also advise students of the availability of the **Study Guide**, which contains chapter summaries, objective questions, and exercises for each chapter. The answers to the questions and exercises appear following each chapter in the **Study Guide**.

It is the nature of accounting that new concepts tend to build upon those that have come before. Therefore, we place a high priority on impressing the students with the importance of getting right to work and of keeping up with the progress of the class. Our experience has shown repeatedly that students who get off to a slow start or who fall behind early in the course will have increasing difficulty as the course progresses. Therefore, we recommend assigning a heavy homework load immediately.

"Accounting" is much more than crunching numbers In teaching accounting, it too often happens that all available class time is spent demonstrating mechanical techniques and solving quantitative problems. Many students, however, have very little understanding of the environment in which accounting information is developed and used. Without this understanding, the relevance of accounting procedures and computations may not be apparent.

We urge instructors to give appropriate classroom time to introducing this environment. We favor in-class reviews of assignments emphasizing the **use** and **interpretation** of accounting information. This is especially true of the *Your Turn* and *Case in Point* cases included within the main body of the text. In addition, those problems that involve well-known companies introduce elements of the business community with which the student is at least partially familiar.

We also encourage instructors to address the many **nonquantitative** aspects of accounting, such as the information needs of decision-makers, accounting theory, systems design, internal control, auditing, ethics, and issues involving professional judgment. If students are to really "learn accounting," these topics deserve attention in both the classroom and in the textbook. One of our major goals in this eleventh edition is to offer examples, text discussions, and assignment materials that better illustrate what accounting "is all about."

In covering Chapter 1, we like to provide students with an overview of both the external and internal reporting process. Exercises **3** and **10** provide a good framework for this discussion. We also like to discuss Case **1** in class. The Internet assignment for this chapter provides an excellent opportunity to introduce students to this important research tool that will be used throughout the text.

Supplemental Exercises

Group Exercise

Have student groups interview senior accounting majors and/or graduate accounting students and report on the career options their student colleagues are investigating.

Internet Exercise

Access the Microsoft web page <http://www.microsoft.com> and choose *About Microsoft*. Click on *Investor Relations* and go to the Annual Report for 2009. In the *Discussion and Analysis* section, review the rate of growth of Microsoft revenues. How does Microsoft seem to be doing compared to the sales of other high tech products? Which accounting firm audited Microsoft in 2009? What impression does the auditor's report convey?

CHAPTER 1 NAME _____ # _____

10-MINUTE QUIZ A SECTION _____

Indicate the best answer for each question in the space provided.

- _____ 1 The best definition of an accounting system is:
- a Journals, ledgers, and worksheets.
 - b Manual or computer-based records used in developing information about an entity for use by managers and also persons outside the organization.
 - c The personnel, procedures, devices, and records used by an entity to develop accounting information and communicate this information to decision makers.
 - d The concepts, principles, and standards specifying the information which should be included in financial statements, and how that information should be presented.
- _____ 2 Suppose a number of your friends have organized a company to develop and sell a new software product. They have asked you to loan them \$7,000 to help get the company started, and have promised to repay your \$7,000 plus 10% interest in one year. Of the following, which amount may be described as the return on your investment?
- a \$7,000.
 - b \$ 700.
 - c \$7,700.
 - d Some other amount.
- _____ 3 Which of the following is generally *not* considered one of the general purpose financial statements issued by a corporation?
- a Income statement forecast for the coming year.
 - b Balance sheet.
 - c Statement of financial position.
 - d Statement of cash flows.
- _____ 4 All of the following are characteristics of management accounting, *except*:
- a Reports are used primarily by insiders rather than by persons outside of the business entity.
 - b Its purpose is to assist managers in planning and controlling business operations.
 - c Information must be developed in conformity with generally accepted accounting principles or with income tax regulations.
 - d Information may be tailored to assist in specific management decisions.
- _____ 5 Which of the following is *not* an objective of financial reporting?
- a Provide information useful in assessing amount, timing, and uncertainty of future cash flows.
 - b Provide information useful in making investment and credit decisions.
 - c Provide information about economic resources, claims to resources, and changes in resources and claims.
 - d Provide information to guarantee the enterprise achieves its goals, objectives, and mission.

CHAPTER 1 **NAME** _____ **#** _____

10-MINUTE QUIZ B **SECTION** _____

Match the organizations on the left with the descriptions on the right. Each description should be used only once.

Organization	Description
_____ Financial Accounting Standards Board .	a. Government agency that regulates financial reporting by publicly-held companies.
_____ Securities and Exchange Commission	b. International organization dedicated to the advancement of internal auditing.
_____ American Accounting Association	c. Private organization most directly involved in the development and issuance of accounting standards.
_____ Institute of Internal Auditors	d. Organization dedicated to the advancement of accounting education and research.
_____ American Institute of CPAs	e. Organization most involved with the ethical conduct of the accountants working within a company.
_____ Institute of Management Accountants	f. Organization which develops formal standards for auditing in the United States.
_____ Internal Revenue Service	g. A government agency that handles income tax returns of individuals and businesses and performs an audit function [to] verify the data presented.
_____ International Accounting Standards Board	h. An organization which develops international accounting standards.
_____ Committee of Sponsoring Organizations.	i. An organization dedicated to improving financial reporting through ethics, internal controls, and corporate governance.

CHAPTER 1 **NAME** _____ **#** _____

10-MINUTE QUIZ C **SECTION** _____

The following is a list of various characteristics of accounting information. In the space provided identify each as a characteristic of either financial or management accounting information.

1. The information is summarized in a set of statements distributed to the public.

2. The information is historical in nature. It reports the results of events and transactions that have already occurred.

3. The timeliness of the information is more critical than its completeness.

4. To increase its usefulness to investors and creditors, the information is usually accompanied by explanations from management.

5. The information is intended to be used for planning and control decisions.

CHAPTER 1 **NAME** _____ **#** _____

10-MINUTE QUIZ D **SECTION** _____

Provide concise written answers to the following:

1. Investors and creditors are interested in a company's "cash flow prospects." What two specific concerns of investors and creditors are summarized by the term "cash flow prospects?"

2. List three financial statements that are used to communicate financial accounting information to interested external parties.

3. Provide a brief example to illustrate that externally reported financial accounting information must be based in part on estimates, judgments, and assumptions.

4. Briefly explain how generally accepted accounting principles enhance the integrity of financial accounting information.

SOLUTIONS TO 10 MINUTE QUIZZES

QUIZ A

- 1** C
- 2** B
- 3** A
- 4** C
- 5** C

Learning Objective: 01-02, 01-03, 01-04

QUIZ B

Financial Accounting Standards Board	c
Securities and Exchange Commission	a
American Accounting Association	d
Institute of Internal Auditors	b
American Institute of CPAs	f
Institute of Management Accountants	e
Internal Revenue Service	g
International Accounting Standards Board	h
Committee of Sponsoring Organizations	i

Learning Objective: 01-06

QUIZ C

- 1** Financial
- 2** Financial
- 3** Management
- 4** Financial
- 5** Management

Learning Objective: 01-03, 01-04

QUIZ D

- 1** Return of investment and return on investment.
- 2** Balance sheet (Statement of financial position)
Income statement
Statement of cash flows
- 3** To account for the use of long lived equipment, estimates must be made of the lifetime and scrap value of that equipment
- 4** Adherence to generally accepted accounting principles assures comparability of accounting information among organizations.

Learning Objective: 01-02, 01-03, 01-05

Assignment Guide to Chapter 1

	Exercises	Cases				Net
	1 – 16	1	2	3	4	5
Time estimate (in minutes)	< 15	15	15	15	30	30
Difficulty rating	E	E	M	E	M	M
Learning objective:	1, 16					
1. Discuss accounting as the language of business and the role of accounting information in making economic decisions.				√		
2. Discuss the significance of accounting systems in generating reliable accounting information and understand the five components of internal control per COSO's <i>Internal Control-Integrated Framework</i> .						
3. Explain the importance of financial accounting information for external parties – primarily investors and creditors – in terms of the objectives and characteristics of that information.	2, 3, 6, 7, 9, 16		√			
4. Explain the importance of accounting information for internal parties – primarily management - in terms of the objectives and characteristics of that information.	2, 7, 9, 10					
5. Discuss elements of the system of external and internal financial reporting that create integrity in the reported information.	7, 12, 13, 16	√				
6. Identify and discuss several professional organizations that play important roles in preparing and communicating accounting information.	4, 5, 8, 11					√
7. Discuss the importance of personal competence, professional judgment, and ethical behavior on the part of accounting professionals.	7, 14				√	√
8. Describe various career opportunities in accounting.	15					