

INTRODUCTION

Role of Accounting

Sound decisions made by individuals, businesses, governments, and other entities in a society are essential for the efficient distribution and use of the nation's scarce resources. To make such decisions, these groups need reliable information, mostly financial and provided by the accounting system. Therefore, accounting plays an important role in our economic and social system and its function is vital to both a *profit-seeking enterprise and a not-for-profit one*.

Profit-seeking enterprises need accounting to keep a diary of their business activities, whether to be used by their managers for decision-making or to be reported to outsiders. Large corporations, for example, are accountable to many parties in the society and they have to report to stockholders, governmental agencies, and to the public.

Government officials also rely on accounting information to help them direct the affairs of their agencies just as do the executives of corporations. However, accounting for governmental activities requires a somewhat different approach because the objective of earning a profit is absent for government activities. Universities, hospitals, churches, and other not-for-profit institutions also follow a pattern of accounting that is similar to governmental accounting. This book is based on the accounting concepts of profit-seeking enterprises, which are often termed business enterprises.

Users of Accounting Information

As it is noted above, the primary use of accounting information is for decision making by different users about an economic entity. Two groups of users make decisions based on information provided by the accounting system. Internal users, who are executives and managers, need information for planning and controlling the affairs of the entity. External users have supplied money to the business or have some other interest in the business that will be served by information about its financial position and operating results. This second group includes owners, lenders, bankers, other creditors, labor unions, governmental agencies, and public.

Managerial and Financial Accounting

To satisfy the need of both internal and external users, the accounting function has evolved into two specialized fields: managerial and financial accounting. Managerial accounting employs both historical and estimated data, which management uses in conducting and evaluating current operations, and in planning future operations. In

contrast, financial accounting is concerned with the measuring and recording of transaction for a business enterprise and the periodic preparation of various reports from such records. The reports, which may be for general purposes or for special purpose, provide useful information for external users.

Accounting System

It must be noted that, both financial and managerial accounting data are produced from the same accounting system. An accounting system consists of the methods and devices used by an entity to keep track of its financial activities and to summarize these activities in a manner useful to decision-makers. Large business entities may use high-speed computer techniques to handle massive quantities of data, but they are based on the basic concepts of a manual system, which is actually used by small business entities.

Bookkeeping

In every accounting system, manual or computerized, the data concerning each the day's financial activities must be measured, recorded, classified, and summarized. This phase of accounting, called bookkeeping, is only a small part of accounting and probably the simplest part. A person might become a Proficient Bookkeeper in a few months; however, to become a professional accountant requires several years of academic study and experience. Accounting includes not only the bookkeeping process but also the design of efficient accounting systems, the performance of audits, preparing income tax return, doing forecasts, and rendering consulting services.

Financial Reporting

The process of supplying general-purpose reports to people outside the organization is termed financial reporting. In the United States and most other industrialized countries, publicly owned corporations are required to make much of their financial information public-that is, available to everyone. These countries also have enacted laws to ensure that the public information provided by these companies is reliable and complete.

Financial Statements

The main part of financial reporting is a set of accounting reports called financial statements. Financial statements summarize in a few pages the financial resources, obligations, profitability, and cash flows of a business. A complete set of financial statements includes balance sheet, income statement, statement of owners' equity, and statement of cash flows. Several pages of notes, containing additional information, are also accompanied to the statement.

Accounting Principles

The core of general-purpose financial accounting and reporting is generally accepted accounting principles (GAAP). These principles have been developed by the accounting profession over the years in an attempt to provide consistent financial statements. The authority of accounting principles rests on their general acceptance by the accounting profession. GAAP encompass not only accounting principles, but also various procedures for applying these principles.

Many organizations play an active role in developing generally accepted accounting principles and in improving the quality of financial reporting in the United States. Among the most influential of these organizations is the Financial Accounting Standard Board (FASB), the American Institute of Certified Public Accountants (AICPA), the Security and Exchange Commission (SEC), and the American Accounting Association (AAA).

Auditing

The development of the corporations created a new social need for an independent audit to provide some assurance that management's financial representations were reliable. In large part, this assurance is provided by an audit, performed by a firm of certified public accountants (CPAs). This audit function, also called attest function, was chiefly responsible for the creation and growth of the public accounting profession.

Future of Accounting

Changes in the environment in which organizations operate will inevitably be accompanied by alterations in accounting concepts and techniques. Due to such environmental changes, three areas will receive increased attention in the near future-computerized accounting systems, international accounting, and socioeconomic accounting.