**Accounting Notes**  Chapter 1

Information that is provided to external parties who have an interest in a company is sometimes referred to as financial accounting information.

Information used internally by management and others is commonly referred to as managerial accounting information.

Both serve different purposes and serve different audiences, yet have certain attributes in common

**ACCOUNTING INFORMATION: A MEANS TO AN END**

The primary objective of accounting is to provide information that is useful for decision making purposes.

NOT an end, but rather it is a means to an end.

The final product of accounting information is the decision that is enhanced by the use of that information. Whether the decision is made my owners, management, creditors, governmental regulatory bodies, labor unions, or the many other groups that have an interest in the financial performance of an enterprise.

**Accounting from a user’s perspective**

Accounting information is the means by which we measure and communicate economic events (ex : managing a business, make investments, monitoring how you receive and use your money :all are working with accounting info)

Accounting information in making economic decisions…..must understand

* The nature of economic activities that accounting information describes
* The assumptions and measurement techniques involved in developing accounting information
* The information that is most relevant for making various types of decisions

The accounting process produces accounting info used by decision makers in making economic decisions and taking specific actions

The accounting process -> accounting information -> (reported results of actions(decisions))->Decision makers -> (actions (decisions))->economic activities ->>>>>

**TYPES OF ACCOUNTING INFORMATION**

Types of accounting information

1. Financial accounting: refers to information describing the financial resources, obligations, and activities of an economic entity (either an organization or an individual). Accountants use the term *financial position* to describe an entity’s financial resources and obligations at a point in time and the term *results of operations* to describe its financial activities during the year.

Financial accounting information is designed primarily to assist investors and creditors in deciding where to place their scarce investment resources.

1. Management (managerial) accounting: involves the development and interpretation of accounting information intended specifically to assist management in operation the business.

Companies constantly need information to run and control daily business operations.

Example: they need to know the amount of money in the company’s bank accounts; the types, quantities, and dollar amounts of merchandise in the company’s warehouse; and the amounts owed to specific creditors.

1. Tax accounting: it results from a different system and complies with specialized legal requirements that relate to a company’s responsibility to pay an appropriate amount of taxes.

**ACCOUNTING SYSTEMS**

An accounting system consists of the personnel, procedures, technology, and records used by an organization by…

1. To develop accounting information
2. To communicate this information to decision makers……

In small businesses, accounting systems may consist of little more than a cash register, a check book, and an annual trip to an income tax preparer. In large businesses, accounting systems include computers, highly trained personnel, and accounting reports that affect the daily operations of every department.

The basic purpose of the accounting system is to meet the organization’s needs for information as efficiently as possible

Many factors affect the structure of the accounting system within a particular organization…most important ones are….

1. The company’s *needs for accounting information*
2. *The resources available* for operation of the system

**Determining Information Needs**

The need for some types of accounting information may be prescribed by law

It depends on how useful management considers the info to be and the cost of developing the info

**The Cost of producing accounting info**

Accounting systems must be cost-effective….that is, the value of the information produced should exceed the cost of producing it

**Basic Functions of an ACCOUNTING SYSTEM**

In developing information about the activities of a business, every accounting system performs the following basic functions:

1. INTERPRET and RECORD the effects of business transactions
2. CLASSIFY the effects of similar transactions in a manner that permits determination of the various totals and subtotals useful to management and used in accounting reports.
3. SUMMARIZE and COMMUNICATE the information contained in the system to decision makers.

Differences in accounting systems arise primarily in the manner, frequency, and speed with which these functions are performed

**Who designs and installs accounting systems?**

Accounting systems generally are designed and installed by a team of people with many specialized talents.

**COMPONENTS OF INTERNAL CONTROL**

Internal control is a process designed to provide reasonable assurance that the organization produces reliable financial reports, complies with applicable laws and regulations, and conducts its operations in an efficient and effective manner.

The FIVE (5) components of internal control are

1. Control Environment: is the foundation for all the other elements of internal control, setting the overall tone for the organization. Factors that affect control environment are
   1. The integrity, ethical values, and competence of the company’s personnel
   2. Management’s philosophy and operation style
   3. Management’s assignment of authority and responsibility
   4. Procedures for the hiring and training of personnel
   5. Oversight by the board of directors.

The control environment is particularly important because fraudulent financial reporting often results from an ineffective control environment.

1. Risk assessment: involves identifying, analyzing, and managing those risks that pose a threat to the achievement of the organization’s objectives.

For example: a company should assess the risks that might prevent it from preparing reliable financial reports and then minimize those risks.

1. Control Activities: are the policies and procedures that management puts in place to address the risks identified during the risk assessment process. (examples: approvals, authorizations, verifications, reconcilliations)
2. Information + Communication: involves developing information systems to capture and communicate operational, financial, and compliance-related information necessary to run the business.
3. Monitoring: All internal control systems need to be monitored. Monitoring enables the company to evaluate the effectiveness of its system of internal control over time.

SOX (Sarbanes-Oxley Act) has been described as the most far-reaching securities law since the 1930s. One of the SOX requirements is that public companies must issue a yearly report indicating whether they have an effective system of internal control over financial reporting.

Internal Control system provides reasonable assurance that financial statements will be prepared in accordance with laws and regulations governing financial reporting.

**Financial Accounting Information**

Financial Accounting provides information about the financial resources, obligations, and activities of an enterprise that is intended for use primarily by external decision makers- investors and creditors.

**External users of ACCOUNTING INFORMATION**

External Users of accounting information are individuals and other enterprises that have a current or potential financial interest in the reporting enterprise, but that are not involved in the day-to-day operations of that enterprise. External users of financial information may include the following: owners, creditors, suppliers, customers, trade associations…etc.)

Example: Customers who purchase from the enterprise need information to allow them to assess the quality of the products they buy and the faithfulness of the enterprise in fulfilling warranty obligations.

Providing information that meets the needs of such a large set of diverse users is difficult, if not impossible, in a single set of financial information. Therefore, external financial reporting is primarily used by two groups- investors and creditors.

Investors are individuals and other enterprises that own the reporting enterprise.

Creditors are individuals and other enterprises to whom the reporting entity owes money, goods, or services. Example: a commercial bank may have loaned money to the reporting enterprise, or a supplier may have permitted the reporting enterprise to purchase goods and to pay for those goods later.

Investors AND Creditors are often referred to as the primary external financial information users.

**Objectives of external financial reporting**

If you had invested in a company, or if you had loaned money to a company…you probably would be interested in two things, both of which make up the company’s **cash flow prospects**.

You would be interested in the return to you at some future date of the amount you had invested or loaned. We refer to this as the return of your investment. In addition, you would expect the company to pay you something for the use of your funds, either as an owner or a creditor. We refer to this as the return *on* your investment. Information that is useful to you in making j about the company’s ability to provide you with what you expect in terms of the return *of* your funds as well as a return *on* your funds while you do not have use of them is what we mean by information about *cash flow prospects.*