

CHAPTER 1: ACCOUNTING AND THE BUSINESS ENVIRONMENT

Objective 1 - Use accounting vocabulary.

Accounting is a system that measures business activities, processes that information into reports, and communicates the results to decision-makers.

There are many users of accounting information. Individuals use accounting information to make decisions about purchases and investments and to manage their bank accounts. Businesses use accounting information to set goals for their businesses and to evaluate progress toward achieving those goals. Investors (shareholders) use accounting information to evaluate the prospect of future returns on their investments. Creditors use accounting information to evaluate a borrower's ability to meet scheduled repayments of money loaned. Accounting information is also used by government regulatory agencies, like the Australian Securities and Investments Commission [ASIC], taxing authorities, non-profit organisations, and others, such as employee and consumer groups.

Accounting has a long history; it is said to have been used to track the costs of major ancient constructions. Double entry bookkeeping can be traced back to Italy over 500 years ago. Today professional accounting bodies such as **Institute of Chartered Accountants in Australia** (ICAA), **CPA Australia** (CPAA) and the **Chartered Institute of Management Accountants** (CIMA) promote the profession and high ethical standards.

The study and practice of accounting may be categorised in a number of ways. In this textbook the first nineteen chapters deal with financial accounting: the gathering and reporting of information to those outside the organisation. The last five chapters look at management accounting: information for internal decision-makers. Accountants may work in industry (for a company, not-for-profit organisation or government department) or in an accounting business (Chartered Accountant or CPA) that consults and provides services to industry. There are many specialist areas in accounting: auditing, tax, management consulting, insolvency, information systems, budgeting, etc.

The three main forms of business organisation we look at in this textbook are:

1. **proprietorship** - or 'sole trader', a business owned by one person
2. **partnership** - a business owned by two or more individuals
3. **company** - a business owned by shareholders whose liability for business debts is limited to the amount the stockholders invested in the company.

It is not until Chapter 13 that the concept of more than one owner is introduced. Almost all the procedures that apply to a proprietorship are relevant to partnerships and companies.

In the Australia, proprietorships are the largest form of business numerically, whereas companies are the dominant form in terms of total assets, revenue, and number of employees. (Helpful hint: Review Exhibit 1-4 in the textbook page 9.)

Objective 2 - Apply accounting concepts and principles.

The rules governing accounting practice are called **Generally Accepted Accounting Principles** (GAAP), which include many standards, or rules, seven of which are: 1) the **entity concept**, 2) the **time period concept**, 3) the **cost principle**, 4) the **matching principle**, 5) the **profit recognition principle**, 6) **conservatism** or **prudence principle** and 7) the **going-concern principle**.

The **entity concept** states that the records of a business entity should be separate from the personal records of the owner. For example, if a business owner borrows money to remodel her home, the loan is a personal debt, not a debt to the business.

The **accounting period concept** defines the period of time for which data is collected and reports are prepared. Businesses need periodic reports to assess their ongoing performance. In Australia companies are required to report at least once a year, usually for the year ended June 30.

The **cost principle** states that the assets and services should be recorded at their actual (historical) cost. For example, if a firm pays \$10,000 for land, then \$10,000 is the value recorded in the books, even if an independent appraiser states that the land is worth \$12,000.