

Kentucky Class Notes

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ACC 201 Doxey
Fall 2010
Test 1

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Chapter 1

Accounting, the “language of business” (1) measures business activities, (2) processes data into reports, and (3) communicates results to financial statement users.

The users of accounting information

- (1) **Individuals** are everyday people who, for example, manage their bank accounts.
- (2) **Investors and Creditors** provide the money to finance a business. Investors want to know how much income they can expect to earn on an investment. Creditors want to know how much a business is going to pay them back.
- (3) **Regulatory Bodies.** Various state and local governments require businesses, individuals, and other organizations to pay income, property, and other taxes. Example: IRS, SEC
- (4) **Nonprofit Organizations** base many of their operational decisions on accounting data. Example: Churches, hospitals, charities.

Types of Accounting

Financial Accounting provides information for external users. Example: Investors, creditors, government, the public.

Managerial Accounting provides information for internal users (managers). Example: The information is used for budgets, forecasts, and projections.

Conceptual Frameworks

Objective The overall objective of accounting is to provide financial information that is useful to present and potential capital providers (investors and creditors) in making investment and lending decisions.

Fundamental Qualitative Characteristics

- (1) **Relevance** – To be relevant, information must be able to make a difference to the decision maker.

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(2) Faithful representation – To faithfully represent, the information must be complete, free from bias, and accurate.

Enhancing Qualitative Characteristics

- (1) Comparability – The accounting information for a company must be able to be compared with information from other companies and consistent with information from previous periods.
- (2) Verifiability – The information must be able to be checked for accuracy, completeness, and reliability.
- (3) Timeliness – The information must be available to users early enough for them to make decisions.
- (4) Understandability – The information must be capable of making sense to users of the information.

Constraints

- (1) Materiality – The information must be important enough to the users so that if it were taken away, it would make a difference in the user's decisions.
- (2) Cost – The cost to produce information should not exceed the expected benefits to the users.

Assumptions and Principles

Entity Assumption – States that a business is a separate economic unit.

Continuity (Going-Concern) Assumption – States that an entity will continue to exist indefinitely.

Historical Cost Principle – States that assets should be recorded at their actual cost.

Stable Monetary Unit Assumption – States that accountants assume that the dollar's purchasing power is stable over time.

Accounting Equation Elements

Accounting Equation: Assets = Liabilities + Owner's Equity

Assets are economic resources that produce future benefit.

Assets include cash, accounts receivable, notes receivable, inventory, prepaid expenses, land, buildings, equipment, furniture, and fixtures.