

# CHAPTER 1

## ACCOUNTING: THE LANGUAGE OF BUSINESS

### **Chapter Opener: Thinking Critically**

A basic understanding of accounting would assist in the interpretation and analysis of financial statements released by a company like Google and would therefore make the financial position of the company more clear and a decision to purchase (or not purchase) its stock more straightforward.

### **Fast Facts**

- Google’s mission is to organize the world’s information and make it universally accessible and useful.
- “Googol” is the mathematical term for a 1 followed by 100 zeros. Google’s play on the term reflects the company’s mission to organize the immense amount of information available on the web.
- Google’s interface can be customized into more than 100 languages.
- Google’s culture is unlike any in corporate America—lava lamps and large rubber balls dot company headquarters and the company’s chef used to cook for the Grateful Dead. Google Inc. puts employees first when it comes to daily life in all of their offices.

### **Managerial Implications: Thinking Critically**

Managers use financial information to make decisions about adding new products and services, offering current products and services, and choosing vendors.

### **Discussion Questions**

*Note to instructor:* These questions are designed to check students’ understanding of new terms, concepts, and procedures presented in the chapter.

1. Owners and managers: evaluate operations. Suppliers: assess ability of a firm to pay debts. Banks: ability to repay loans. Tax authorities: determine a tax base. Governmental agencies: legal compliance. Employees: wage levels and profit-sharing plans.
2. Regulation of financial reporting by publicly owned corporations.
3. Sole proprietorship (owned by one person). Partnership (owned by two or more people). Corporation (can be owned by one person or many).
4. Measure business performance; separate entity.
5. Statements of Financial Accounting Standards.
6. SEC, AICPA, AAA.
7. Public, managerial, and governmental.
8. Auditing, tax, and management advisory services.
9. Advice on how to structure financial affairs in order to reduce taxes without violating tax laws.
10. Establish accounting policies, direct the accounting system, prepare and interpret financial statements, provide financial advice, prepare tax forms.
11. The Public Company Accounting Reform and Investor Protection Act of 2002 was passed in response to the wave of corporate accounting scandals starting with the demise of Enron Corporation in 2001, the arrest of top executives at WorldCom and Adelphia Communications Corporations, and ultimately, the demise of Arthur Andersen, an international public accounting firm.
12. The purpose of the Public Company Accounting Oversight Board is to oversee the accounting profession through its investigative and enforcement powers and to discipline corrupt accountants and auditors.

### **CRITICAL THINKING PROBLEM 1.1**

Student answers will vary. The student's reasons for choosing one form of ownership over another are more important than the specific choice made.

#### **Sole proprietorship:**

Advantage—Ned would be his own boss and could direct the business as he wants.

Disadvantages—Ned would be responsible for the debts and taxes of the business and may be limited in the amount of capital he could borrow to finance the business.

#### **Partnership:**

Advantage—Ned would have one or more partners to assist with business operations and to contribute capital.

Disadvantages—Ned would have to share control of the business, as well as its profits. Ned could be liable for the debts of the partnership.

#### **Corporation:**

Advantages—The business would be a separate entity. Capital would be easier to raise and liability would be limited to the assets of the business.

Disadvantages—A corporation is a more complicated form of ownership and is usually more expensive to form. There is also more government regulation and, consequently, more paperwork with a corporation.

## **SOLUTIONS TO BUSINESS CONNECTIONS**

### **Managerial Focus:**

1. Financial information is used to evaluate performance and make decisions about a business or a nonprofit organization.
2. The manager makes financial decisions based upon the financial information provided by the accountant.
3. Every business needs an efficient accounting system which accumulates financial data, classifies and summarizes the information. Without an accounting system, suppliers, lenders, investors, and governmental tax authorities would not be able to accurately make decisions based on the financial information of the company.
4. Analyze financial statements and review accounting procedures for internal controls.
5. Keep your employees, creditors, and investors happy. Yes, financial information is a tool for making business decisions that will yield the above results.
6. Inaccurate accounting records and poor business decisions.
7. These standards are important to management because they enhance comparability of reporting practices.
8. Yes. The firm's financial records need to be separate from the owner's personal financial records in order to evaluate and measure the performance of the business.

### **Ethical Dilemma:**

Yes. Ethics and accounting are intertwined.

### **Financial Statement Analysis:**

#### **Analyze Online:**

1. Economic entity because it is a business for profit.
2. Clothing, accessories, outerwear and footwear.
3. Investors, suppliers, and banks. To assist the users when making financial decisions.
4. 15 to 25 year-olds.

### **Teamwork:**

Balance Sheet, Income Statement and Cash Flow Statement should be required. Anticipated cost of expansion and future income projections may also be requested. Banks might also require a list of your customers and vendors. There is no requirement to indicate to the bank problems you are having with certain customers and vendors.

### **Internet Connection:**

As of June 2009, 168 statements have been issued. The statements are listed in reverse chronological order.

# SOLUTIONS TO PRACTICE TEST

## **Part A True-False**

1. TRUE
2. TRUE
3. TRUE
4. FALSE
5. FALSE
6. FALSE
7. TRUE
8. TRUE
9. FALSE
10. TRUE
11. FALSE
12. FALSE
13. FALSE

## **Part B Completion**

1. IRS
2. stockholders or shareholders
3. shares of stock
4. partnerships
5. social entity
6. recording, classifying
7. financial statements
8. language of business
9. international accounting
10. FBI
11. governmental accounting
12. AAA
13. AICPA
14. generally accepted accounting principles
15. SEC

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