Lesson no. 1 – What is Business Accounting

Business accounting consists of three basic activities: identifying, recording and communicating the economic events of a company. Accountants identify economic events such as transactions and investments. Accountants use bookkeeping techniques to systematically record economic events. Finally, accountants use financial statements to present their records to people who use accounting information. Sometimes, accounting might also mean analyzing and interpreting financial statements and explaining the meaning of reported data.

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Accounting Information Users

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Two broad groups of people use business financial statements, internal users and external uses. Internal users need accounting data to help them run the company. Internal users include marketers, supervisors and financial officers. Managerial accountants manage and report information to internal users.

External users usually need accounting information for investment or legal reasons. External users include investors, creditors and government agencies. Financial accountants manage and report information to external users.

Elements of the Accounting Equation

Business accounting financial records describe what a business is owed and what it owns. What a business owns is called “assets.” What a business owes is split into two categories, liabilities (credit debts) and stockholders’ equity (investor debts). “Assets=Liabilities+Stockholders’ Equity” is the accounting basic equation that all accountants use to record and report.

This equation is the same for a huge corporation as it is for the restaurant around the corner. Accounting red flags should go up if assets fail to equal liabilities and equity.

Generally Accepted Accounting Principles

The agencies that regulate U.S. accounting and financial markets, the Securities and Exchange Commission, and the Financial Accounting Standards Board, created a set of universal accounting standards known as Generally Accepted Accounting Principles, or GAAP. GAAP ensure that all accountants identify, record and report the same way. GAAP dictates that accountants use the cost principle, meaning that accounting items are always recorded at their initial cost.

GAAP also imposes assumptions, such as the monetary unit assumption that describes transactions as data expressed in monetary terms, and the economic entity assumption that legally describes business types.

Accounting Ethics and Oversight

Ethics is fundamental to accounting because so many people depend on honest and error-free financial statements. In 2002, several high-profile accounting scandals involving AIG, Enron, WorldCom and others, crippled the economy. The government responded by initiating the Sarbanes-Oxley Act of 2002 (SOX) a law that holds company financial officers directly responsible for accounting fraud and oversight. SOX law and other accounting laws combine with ethical sensibilities to create accounting data that users can trust.

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