

# Definition of Accounting

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- **Accounting is a system for recording information about business transactions to provide summary statements of a company's financial position and performance to users who require such information**
- **Three sets of books**
  - **Financial accounting**
    - Standardized reports for external stakeholders
  - **Tax accounting**
    - IRS rules for computing taxes payable
  - **Managerial accounting**
    - Custom reports for internal decision making

# What are the financial reporting requirements?

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- **The Securities and Exchange Commission (SEC) requires periodic financial statement filings:**
  - 10 – K: Annual report
  - 10 – Q: Quarterly report
  - 8 – K: Current report (material events)
  - Must be prepared in accordance with Generally Accepted Accounting Principles (GAAP)
- **Periodic filing requirements create much of the “tension” in financial accounting**
  - Ship goods to a customer in one quarter, collect cash in the next
    - When did the sale occur?
  - Buy equipment in one quarter, use it for the next 23 quarters
    - When does the expense occur?

## Who makes the rules?

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- **Generally Accepted Accounting Principles (GAAP) established by:**
  - U.S. Congress, but they delegate to:
  - The SEC, but they delegate to:
  - Financial Accounting Standards Board (FASB)
    - Emerging Issues Task Force (EITF)
    - American Institute of CPA's (AICPA)
- **International Financial Reporting Standards (IFRS) are established by the IASB and are required in over 100 countries**
  - US GAAP is still required for US firms
  - For intro accounting topics, there is a high degree of overlap in the two standards

# Who is responsible for financial reporting?

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- **Management is responsible for preparing financial statements**
  - The Audit Committee of the Board of Directors provides oversight of management's process
  - Auditors are hired by the Board to “express an opinion” about whether the statements are prepared in conformity with GAAP
- **The SEC and other regulators take action against the firm if any violations of GAAP or other rules are found**
- **Information intermediaries (stock analysts, institutional investors, the media) may expose or flee firms with questionable accounting**

# What are the required financial statements?

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- **Balance Sheet**
  - Financial position (listing of resources and obligations) *on a specific date*
- **Income Statement**
  - Results of operations *over a period of time* using accrual accounting (i.e., recognition tied to business activities)
- **Statement of Cash Flows**
  - Sources and uses of cash *over a period of time*
- **Statement of Stockholders' Equity**
  - Changes in stockholders' equity *over a period of time*