OBM3102

FOUNDATION IN BUSINESS

SELF INSTRUCTIONAL MATERIALS

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FACULTY OF BUSINESS, HUMANITIES & HOSPITALITY

BACHELOR OF COMMERCE (HONS) IN INTERNATIONAL BUSINESS

Topic 14 ► Accounting

LEARNING OUTCOMES

By the end of this topic, you will be able to:

1. Explain how accounting works;
2. Explain 4 types of accounting;
3. Provide at least 5 reasons why accounting is important.

► INTRODUCTION

Accounting is important as it keeps a systematic record of the organization's financial information. Up-to-date records help users compare current financial information to historical data. With full, consistent, and accurate records, it enables users to assess the performance of a company over a period of time.

14.1 WHAT IS ACCOUNTING?

Accounting is the process of recording financial transactions pertaining to a business. The accounting process includes summarizing, analyzing, and reporting these transactions to oversight agencies, regulators, and tax collection entities. The financial statements used in accounting are a concise summary of financial transactions over an accounting period, summarizing a company's operations, financial position, and cash flows.

How Accounting Works

Accounting is one of the key functions of almost any business. It may be handled by a bookkeeper or an accountant at a small firm, or by sizable finance departments with dozens of employees at larger companies. The reports generated by various streams of accounting, such as cost accounting and managerial accounting, are invaluable in helping management make informed business decisions.

The financial statements that summarize a large company's operations, financial position, and cash flows over a particular period are concise and consolidated reports based on thousands of individual financial transactions. As a result, all professional accounting designations are the culmination of years of study and rigorous examinations combined with a minimum number of years of practical accounting experience.

History of Accounting

The history of accounting has been around almost as long as money itself. Accounting history dates back to ancient civilizations in Mesopotamia, Egypt, and Babylon. For example, during the Roman Empire, the government had detailed records of its finances.

However, modern accounting as a profession has only been around since the early 19th century. Luca Pacioli is considered "The Father of Accounting and Bookkeeping" due to his contributions to the development of accounting as a profession. An Italian mathematician and friend of Leonardo da Vinci, Pacioli published a book on the double-entry system of bookkeeping in 1494.

By 1880, the modern profession of accounting was fully formed and recognized by the Institute of Chartered Accountants in England and Wales. This institute created many of the systems by which accountants practice today. The formation of the institute occurred in large part due to the Industrial Revolution. Merchants not only needed to track their records but sought to avoid bankruptcy as well.

14.2 TYPES OF ACCOUNTING

Accountants may be tasked with recording specific transactions or working with specific sets of information. For this reason, there are several broad groups that most accountants can be grouped into.

TYPES OF ACCOUNTING	
Financial Accounting	Financial accounting refers to the processes used to generate interim and annual financial statements. The results of all financial transactions that occur during an accounting period are summarized in the balance sheet, income statement, and cash flow statement. The financial statements of most companies are audited annually by an external CPA firm. For some, such as publicly-traded companies, audits are a legal requirement. However, lenders also typically require the results of an external audit annually as

	part of their debt covenants. Therefore, most companies will have annual audits for one reason or another.
Managerial Accounting	Managerial accounting uses much of the same data as financial accounting, but it organizes and utilizes information in different ways. Namely, in managerial accounting, an accountant generates monthly or quarterly reports that a business's management team can use to make decisions about how the business operates. Managerial accounting also encompasses many other facets of accounting, including budgeting, forecasting, and various financial analysis tools. Essentially, any information that may be useful to management falls underneath this umbrella.
Cost Accounting	Just as managerial accounting helps businesses make decisions about management, cost accounting helps businesses make decisions about costing. Essentially, cost accounting considers all of the costs related to producing a product. Analysts, managers, business owners, and accountants use this information to determine what their products should cost. In cost accounting, money is cast as an economic factor in production, whereas in financial accounting, money is considered to be a measure of a company's economic performance.
Tax Accounting	While financial accountants often use one set of rules to report the financial position of a company, tax accountants often use a different set of rules. These rules are set at the federal, state, or local level based on what return is being filed. Tax accounts balance compliance with reporting rules while also attempting to minimize a company's tax liability through thoughtful strategic decision-making. A tax accountant often oversees the entire tax process of a company: the strategic creation of the organization chart, the operations, the compliance, the reporting, and the remittance of tax liability.

14.3 WHY ACCOUNTING IS IMPORTANT

Accounting is a back-office function where employees may not directly interface with customers, product developers, or manufacturing. However, accounting plays a key role in the strategic planning, growth, and compliance requirements of a company.

WHY ACCOUNTING IS IMPORTANT	
Accounting is necessary for company growth.	Without insight into how a business is performing, it is impossible for a company to make smart financial decisions through forecasting. Without accounting, a company wouldn't be able to tell which products are its best sellers, how much profit is made in each department, and what overhead costs are holding back profits.
Accounting is necessary for funding.	External investors want confidence that they know what they are investing in. Prior to private funding, investors will usually require financial statements (often audited) to gauge the overall health of a company. The same rules pertain to debt financing. Banks and other lending institutions will often require financial statements in compliance with accounting rules as part of the underwriting and review process for issuing a loan.
Accounting is necessary for owner exit.	Small companies that may be looking to be acquired often need to present financial statements as part of acquisition or merger efforts. Instead of simply closing a business, a business owner may attempt to "cash-out" of their position and receive compensation for building a company. The basis for valuing a company is to use its accounting records.
Accounting is necessary to make payments.	A company naturally incurs debt, and part of the responsibility of managing that debt is to make payments on time to the appropriate parties. Without positively fostering these business relationships, a company may find itself with a key supplier or vendor. Through accounting, a company can always know who it has debts to and when those debts are coming due.
Accounting is necessary to collect payments.	A company may agree to extend credit to its customers. Instead of collecting cash at the time of an agreement, it may give a customer trade credit terms such as net 30. Without accounting, a company may have a hard time keeping track of who owes it money and when that money is to be received.
Accounting may be required.	Public companies are required to issue periodic financial statements in compliance with GAAP or IFRS. Without these financial statements, a company may be de-listed from an exchange. Without proper tax accounting compliance, a company may receive fines or penalties.

SELF CHECK 14.1

1. Why is accounting important?

Points to Ponder/Takeaways

- Regardless of the size of a business, accounting is a necessary function for decision making, cost planning, and measurement of economic performance.
- Two important types of accounting for businesses are managerial accounting and cost accounting. Managerial accounting helps management teams make business decisions, while cost accounting helps business owners decide how much a product should cost.
- Accounting is an important function of strategic planning, external compliance, fundraising, and operations management.

References

1. https://www.investopedia.com/terms/a/accounting.asp