The UNIVERSITY of VERMONT

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Notes – Topic 1

Introduction to Accounting

I. Purpose of Business
   a. For-Profit. Make money.
   b. Not-for-profit. Provide some service assisting society at large.
   c. Stakeholder.
      i. Has a vested interest in the success of the enterprise.
      ii. Investors
      iii. Management & Workers
      iv. Consumers / Customers
      v. Government
      vi. Suppliers
      vii. Society at Large
   d. Businesses don't *just* try to maximize return to investors, but to please *all* stakeholders.
II. Types of Business
   a. Service firms. Provide some service.
   b. Merchandising firms
      i. Intermediary from distribution standpoint.
      ii. Wal-Mart, distributors, etc.
      iii. "Dis-Intermediatation." Supply chain becomes smaller with online selling. Products go more directly to sellers.
   c. Manufacturing firms. Value-added process.
III. Ownership structures
   a. Sole proprietorship
      i. Single owner.
      ii. Advantage: Simplicity
      iii. Unlimited liability. Personal assets are attached to the business as well as business assets.
   b. Partnership
      i. Multiple individuals
      ii. Unlimited liability
      iii. Some states offer "Limited Liability Partnerships" (LLP)
   c. Corporation
      i. Most important! Most emphasis in class.
      ii. Separate individual entity.
      iii. By far the most are chartered under the state of Delaware.
      iv. Separation of ownership and management.
      v. Limited liability.
      vi. Ease of raising funds.
         1. Can access capital markets
         2. Stock exchanges exist to make stock more liquid.
      vii. Firms outlive their investors.
IV. Corporate Governance
   a. Stockholders elect Board of Directors
   b. Board of Directors appoints Management
V. Accounting
   a. "A process of recording, summarizing, and reporting economic information to decision-makers" – Horngren et. Al.
   b. A system for providing "quantitative information, primarily financial in nature, about economic entities that is intended to be used in making decisions."
   c. Managerial
      i. Future perspective.
      ii. No standards.

        iii. Internal use.
   d. Financial accounting
        i. External use.
        ii. Historic perspective
        iii. Standards
   e. Why study?
        i. Evaluate job opportunities
        ii. Evaluate investments.
        iii. Keep records for business.
   f. System is based on the belief that investors will have access to reliable financial information.
   g. How can we ensure reliabile information?
        i. Standards. “Generally Accepted Accounting Principles.”
        ii. Assurance from third-party. Independent audits.
            1. Touche-Ross
            2. PricewaterhouseCoopers
            3. KPMG Peat Marwick
            4. Ernst & Young
            5. *Formerly:* Arthur Anderson. *Now excluded.*
        iii. Securities & Exchange Commission (SEC)
            1. Oversight.
            2. Regulatory compliance group
            3. Examine reporting of publicly traded companies.
        iv. Financial Accounting Standards Board (FASB)
            1. Norwalk, CT
            2. Seven full-time members from business, academia, accounting.
            3. Responsible for administering GAAP.
        v. What does the investor need to know?
        vi. Propose regulation, await public feedback, amend or implement as appropriate.
   h. Reliability failures
        i. Enron, Worldcom, Adelphia, Tyco
        ii. Auditors and SEC mainly to blame.
            1. Auditors seek other opportunities for income – consulting and tax services.
            2. Conflict of interest to ignore errors in exchange for continued consulting contracts.
        iii. SEC
            1. Current budget = $438M
            2. In 1972 had about 400 attorneys and accountants.
            3. Currently has about 1000.
            4. Trading volume, on the other hand, increased 100 fold.
            5. Not enough resources.
        iv. Politics
            1. SEC tried to legislate against consulting.
            2. Campaign contributors (consultants) shut it down through congress.
        v. Congress’s Response
            1. Increased budget by 66%
            2. Gave $20M immediately to higher new accountants.
            3. Sarbones-Oxley act of 2002
                a. “Most significant … legislation since SEC act of 1933”
                b. Five member oversight board
                    i. Sets and enforces auditing.
                    ii. Attestation.
                    iii. Quality control.
                    iv. Ethics standards.
                    v. Imposes discipline for violations.

c. Limits consulting by auditors.
    i. Cannot do eight things.
        1. Bookkeeping.
        2. IS design and implementation.
        3. Appraisal or valuation
        4. Actuarial services (risk assessment)
        5. Internal audits
        6. Management and HR services
        7. Investment banking
        8. Legal services.
    ii. CPA firms will now likely spin off their consulting business, keeping the audit isolated, which will drive up prices.
d. CFO & CEO must pledge to the accuracy of their statements.
    i. “Shrug”
    ii. Can’t hurt.