

1999/2000 Edition

*Core Concepts of  
Accounting Information*

The  
Users/Uses  
of Accounting  
Information

Karen V. Pincus

*Core Concepts of  
Accounting Information*

# Theme I

## The Users/Uses of Accounting Information

*1999/2000 Edition*

*Karen V. Pincus, Ph.D.*

University of Arkansas

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*Core Concepts of Accounting Information*  
*Theme I: The Users/Uses of Accounting Information*

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To these people and organizations--and especially to the students and teachers now using *Core Concepts of Accounting Information* who provide valuable feedback on many parts of the materials--I express my heartfelt thanks.

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**FEEDBACK ON COURSE MATERIALS**

Comments, corrections, and suggestions for future topics and assignments are greatly appreciated. Address any feedback to:

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## ORGANIZATION OF COURSE MATERIALS

*Core Concepts of Accounting Information* is organized into 4 broad themes:

- Theme I:**        *The Users/Uses of Accounting Information*
- Theme II:**     *Accounting Issues Involving Income and Cash Flows*
- Theme III:**    *Accounting Issues Involving Economic Resources*
- Theme IV:**    *Accounting Issues Involving Capital*

Each theme looks at a variety of topics that cut across the major functional areas of accounting--financial accounting, managerial accounting, systems, tax and auditing. Examples from business, non-profit and government organizations--both domestic and international--are used throughout the themes. Each theme is further divided into modules that follow the same organizational pattern across the themes:

- ◆ The first module of each theme provides an introduction to the theme, describing the key points to be covered and presenting needed terminology.
- ◆ The remaining modules explore the topics of the theme from the perspective of a particular user group for accounting information: management, owners and creditors, government and other users.
- ◆ Theme I also contains a final module on the environment of accounting that introduces the body of technical rules, laws, standards and guidelines in the 5 major functional areas of accounting and discusses how to research accounting questions and problems.

### Pagination

*Core Concepts of Accounting Information* is divided into themes and modules, which different schools put together in a variety of ways.

How do you find material within your bound text? After this preface, pagination is of the form I-2-3, where the initial roman numeral indicates the theme, the middle number indicates the module within the theme, and the final number indicates the page within the module. Thus, page I-2-3 indicates Theme I, Module 2, page 3.

## **PREFACE FOR STUDENTS: THE STUDY OF ACCOUNTING**

*Education bewildered me with knowledge and facts in which I was only mildly interested.*

-- Charles Chaplin, *My Autobiography*

Why are accounting courses required for students of business? Why are they recommended for many non-business students? What are you doing here? Chances are, you're not really sure. In fact, chances are you can come up with a few reasons why you'd rather *not* be here. So, before describing what *Core Concepts of Accounting Information* is about, let's start by considering some of the doubts you might have about studying accounting.

### **ACCOUNTING: THE RUMOR MILL**

*Rumour is a pipe  
Blown by surprises, jealousies and conjectures.*  
-- Shakespeare, *Henry IV, Act 2*

**Rumor #1: Accounting isn't relevant to most majors. It's not of much interest if you're not majoring in Business or if you plan a career in a non-quantitative area of business like Marketing or Human Resource Management.**

This rumor is easy to deal with--it doesn't have a shred of truth. Suppose you are interested in some area of business other than accounting. You still will find yourself relying on accounting information to help you make decisions.

Suppose, for example, you plan a career in marketing. Marketers care a lot about product pricing. Pricing decisions require accounting information. Should an airline lower its fares to increase business? Should an automobile manufacturer offer rebates on its cars to encourage sales? You will need to understand accounting information to help you answer these questions.

Or, suppose you plan a career in human resource management. Human resource managers need information for hiring decisions and performance evaluation. How do you decide how many people to hire for the holiday season in a department store? How do you design a pay scheme that will reward your sales force for helping the company meet its sales targets? Planning for hiring needs requires accounting information, and so does performance evaluation.

There's virtually no area of modern business that doesn't use accounting information for decision-making. Moreover, even if your chosen career path is outside of business,

accounting remains relevant to many social decisions, such as deciding on the appropriate tax policy for a nation or drawing up a budget for a state or local government. How much money is needed to improve roads? How does the amount of money spent to educate each student in one country compare to spending levels in other nations? Will the local performing arts center be able to operate if audiences decrease by 10% next year? To answer all these questions, accounting information is needed.

**Rumor #2: Accounting is highly specialized and requires extensive technical training. So, it's best to leave accounting for accountants.**

There's some truth to this rumor--a few accounting courses won't turn you into an accountant. If you want to be an accountant, you must commit to an extended program of study and mastery of a complex technical body of knowledge. For students who are considering careers in accounting, this course will provide a basis for assessing whether it's worthwhile to pursue that path. But, remember, for most students the goal isn't to become an accountant.

For most students, the goals of studying accounting are to:

- ◆ understand enough about accounting information to recognize when such information could be *useful* to you,
- ◆ understand the advantages and limitations of accounting information you are using in decision making; and, of course,
- ◆ know when you need to hire or work with an accountant to help you fulfill your needs.

Furthermore, if you ever do hire or work with an accountant, you need to know enough about accounting to understand what your accountant is saying. Accounting is often termed "the language of business." You need to speak this language at least well enough to understand what is going on around you.

**Rumor #3: Accounting is boring--it's all rules and calculations. If you hated math, you'll hate accounting.**

This is an interesting rumor. It's not correct, but it's easy to see how students could get this impression. Mostly, it comes from a confusion between bookkeeping and accounting.

In the past, many students began their study of accounting by being thoroughly indoctrinated into the record-keeping fundamentals of accounting (known as bookkeeping). Because bookkeeping can be repetitive and tedious at times, students easily got the impression that accountants spend their days "crunching numbers," with little need for contact with other human beings and little need for judgment or creative thinking. Only those students who continued to take accounting beyond the introductory level found out otherwise. It turns out that accountants deal a lot with people, and they don't deal as often as you might think in "black-and-white" calculations determined by a cookbook of rules.

Fortunately, times have changed. You will not have to become an accounting major to get a complete picture of the role of accountants in society. Thanks to the automation of bookkeeping, which the computer revolution of the late twentieth century brought about, it's no longer necessary to spend six months to a year dwelling on the record-keeping process. You'll learn enough about bookkeeping to understand the basic process, but you'll get to spend the bulk of your time learning about accounting, rather than bookkeeping. The focus of this course will be on the use of accounting information in decision-making.

Accountants do, of course, deal with numbers and good quantitative skills are valuable in accounting. If you decide to major in accounting, a strong mathematics background will be very useful for some specializations. For example, an accountant for a manufacturing firm that produces many different products on the same production line may find it useful to understand mathematical models that can help determine what it costs to make each individual product. However, the only math that you'll need to know for this course is addition, subtraction, multiplication and division--which really shouldn't be intimidating.

**Rumor #4:** Accounting courses are hard--there's lots of work to do in a short time.

Oops. There's a lot of truth to this one. However, hard work shouldn't be a turn-off if the payoff for your work is large enough. So, the next logical thing to think about is what benefits you will derive from studying *Core Concepts of Accounting Information*.

## ACCOUNTING: WHAT'S IN IT FOR ME?

*There's only one corner of the universe you can be certain of improving, and that's your own self.*

-- Aldous Huxley, *Time Must Have a Stop*

As you probably suspect, or at least hope when you pay your tuition, most college courses are designed to provide you with tools for life. Studying accounting should help you develop certain skills and abilities. *Core Concepts of Accounting Information* was designed to help you:

- ◆ understand the nature of various types of accounting information.
- ◆ be able to apply accounting information to a variety of decisions/uses.
- ◆ understand the limitations of accounting information.
- ◆ be able to recognize problems where accounting information might be useful.
- ◆ be able to research relevant professional accounting and business literature to help make decisions/solve problems.
- ◆ be able to express accounting-related ideas both orally and in writing, and communicate these ideas well in one-on-one or team situations.
- ◆ be aware of the importance of ethics and values in dealing with accounting issues.

All this sounds pretty nice, but very abstract. So, how will you be able to apply your knowledge? You should see a difference, between today and the end of this course, in your ability to read and understand accounting-related articles in the business press. As you progress through the course, you should find it easier to determine what kind of accounting information you can use when facing particular decisions such as whether to buy a stock, or whether to vote for a new bond issue, or whether to donate money to a particular charity.

You'll also be able to read and interpret basic accounting information, such as that found in corporate annual reports and auditors' reports. You'll be able to recognize basic control issues and systems design issues and understand their significance to an organization. You'll recognize why taxes play a crucial part in business decisions. You'll understand some of the accounting issues that will be important in the next several decades as business becomes increasingly international. In short, you should find yourself feeling comfortable speaking the language of business.

## LEARNING ABOUT ACCOUNTING INFORMATION: KEYS TO SUCCESS

*Plans get you into things, but you got to work your way out.*

*-- Will Rogers, The Autobiography of Will Rogers*

What does it take to succeed in an accounting course? There *is* a lot of material to cover and most of it will be unfamiliar to you. It's rare that a student has extensive business experience before taking an accounting course, so often you will be struggling to understand basic business concepts as well as basic accounting concepts. There are a half dozen keys to success in learning about accounting information:

- ◆ **Hint #1: Budget Your Time.** Organize your work efforts to cover the scheduled readings and assignments on a timely basis. When learning *Core Concepts of Accounting Information*, you'll find that it's very inefficient--and ineffective--to try to do assignments or follow class discussions without first putting in your reading and thinking time. You'll find that most of the assignments build on the readings, but don't rehash them. They involve thought more than memorization. Since the class meetings and assignments often focus on *applying* the concepts you will learn about in your readings, it helps a lot to do the reading *beforehand*. Each module provides an estimated time budget to serve as a guide. But these numbers are only averages, not promises. You need to adjust the estimates, as needed, to accommodate your own learning style. Early in the course, keep track of the amount of time it takes you to complete scheduled readings and assignments. Use these estimates to budget your time for later sections of the course.
  
- ◆ **Hint #2: Be an Active Learner.** Be prepared to be an active participant in the class discussions. When it comes to discussions, you won't benefit much by just listening. You need to take the risk of trying to apply the concepts you've read about to the new situations being talked about in the classroom. Don't be afraid that what you say will be wrong. Lots of times it will be, but

remember one important thing: if you could already get the right answer most of the time, there wouldn't be much point in taking a course. Sometimes we learn more from mistakes than from getting things right in the first place. Remember that the classroom is a safe place to make mistakes; take advantage of that safety.

- ◆ **Hint #3: Use a Business and Accounting Dictionary.** Often, when a passage or homework assignment is unclear, it's because you don't have a clear understanding of an accounting or business term. For example, if an assignment is talking about a manufacturing company that uses bar codes to identify its products and you don't know what a bar code is, you're bound to be frustrated. Do yourself a favor, look it up. Sometimes a problem or reading will assume that you have everyday knowledge of a business term--for example, assuming you know about bar codes from going to the grocery store. If the assumption is incorrect, protect yourself by looking up the term you don't understand.
- ◆ **Hint #4: Follow Current Business News.** You'll find that following the business news will reinforce what you are learning. Develop the habit of reading the business section of a daily newspaper. Try a trial subscription to a major business periodical--either in print or on the Internet. Catch the business segment of a television or radio news broadcast. The more you follow the business news, the easier it will be for you to see how accounting information can be used in decision making.
- ◆ **Hint #5: Form a Study Group.** Two or more heads are often better than one--at school as well as in the workplace. Unless you are doing an assignment that is to be graded as individual work, there's no reason to work alone. What one student doesn't understand, another might. In effect, you can pool your resources to make your learning process easier. Since group assignments are a part of this course, it should be pretty easy to convert your work group into a study group to work together on readings and studying for exams, as well as the group assignments.
- ◆ **Hint #6: Ask Questions When You Don't Understand Something.** Ask your instructor, ask other students, ask people you know who know something about business and accounting--just ask. Don't sit on your questions waiting for understanding to hit you. Be aggressive in seeking out help.

Will you do well in accounting? If you take advantage of these hints, there's no reason why you shouldn't. Accounting is difficult, but not impossible. If you take control of your own learning, you should be amply rewarded. As one final hint to get you started off right, you'll find a sample assignment on the next page.

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**SAMPLE ASSIGNMENT: Course Overview**

**SETTING**

You are a student facing your first day in your first accounting class. You need to know as much information as possible about the course--when assignments are due, how the course will be graded, when the exams are scheduled, and so on.

**ASSIGNMENT**

Review the syllabus for the course. Make sure you note any questions you need to ask your instructor in class or during office hours.

**HINTS**

This obviously isn't much of an assignment as you probably read the syllabus as soon as you got it. But, it does give you a chance to see how assignments for *Core Concepts of Accounting Information* are set up.

Each assignment begins with a "**SETTING**" that describes the problem situation for you and tells you what role to play. The assignments will usually ask you to apply concepts you have read about to new situations. They ask you to think like someone in the "real world" role you are playing. They give you a chance to "learn by doing."

The "**ASSIGNMENT**" section tells you what your task is. Some of the assignments are designed to be done individually; others are designed to be done in small groups. Some of the assignments may be discussed in class or handed in for grading; others will be self-corrected. Solutions to self-corrected problems will appear at the end of the module.

Finally, each assignment contains some "**HINTS**" for how to proceed. Before you read the hints, quickly try to think about how you will approach the assignment. Then, read the hints and compare them to your plan to see if your approach makes sense. By using the hints this way, you will not only get information about how to handle the specific assignment, you will also be learning about how to structure approaches to problem-solving and decision-making.

**A Hint About Pagination**

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# module 1

**CORE CONCEPTS OF ACCOUNTING INFORMATION**  
**THEME I: The Users/Uses of Accounting Information**

**Karen V. Pincus**

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## **MODULE 1:**

# **INTRODUCTION: WHAT IS ACCOUNTING?**

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