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Unit 1

What Is Financial Accounting?

Learning Objectives

- define financial accounting
- differentiate between financial accounting and managerial accounting
- explain the uses of financial accounting
- list accounting principles and assumptions

Focus on the Topic

Pair Work: Discuss the following questions with your partner.

1. What is the relationship between accounting and financial accounting?
2. What is the use of financial accounting?
3. What principles and assumptions is financial accounting based on?

Vocabulary Study

1. The following words and phrases are from Reading One. Fill in the blanks with them and change the forms where necessary.

| | | | | |
|-----------|------------|------------|------------|-------------|
| interpret | assumption | adhere to | insofar as | to this end |
| internal | underlying | subject to | credible | mandate |

- (1) We must _____ the principle of making study serve the practical purpose.
- (2) The factors that push you out of balance can be external or _____.
- (3) We therefore have to provide more accurate and _____ information.
- (4) For every trait, you can _____ it in a positive and a negative manner.
- (5) NASA and the Russian space agency _____ that landings must occur at least one hour after dawn and one hour before dusk.
- (6) This investment uses financial assets that are _____ market conditions, such as stocks and bonds.
- (7) This project was predicated on the _____ that the economy was expanding.
- (8) The Fed believes the earlier assets purchases worked, _____ they lowered long-term interest rates.
- (9) Lack of effective communication, feedback and trust seem to be the _____ reason for most of the above points.
- (10) _____, particular emphasis would be given the next few years on increasing foreign participation in the institutional investor market.

2. The following accounting terminologies are from Reading One. Match them with their Chinese equivalents.

| | |
|---------------------------|------------------------------------|
| (1) financial accounting | a. <input type="checkbox"/> 财务业绩 |
| (2) financial state | b. <input type="checkbox"/> 历史成本原则 |
| (3) financial health | c. <input type="checkbox"/> 充分披露 |
| (4) financial performance | d. <input type="checkbox"/> 财务健康 |
| (5) financial decision | e. <input type="checkbox"/> 经济实体 |
| (6) cost principle | f. <input type="checkbox"/> 配比原则 |
| (7) matching principle | g. <input type="checkbox"/> 持续经营 |

(Continued)

| | |
|----------------------|----------------------------------|
| (8) full disclosure | h. <input type="checkbox"/> 财务状况 |
| (9) going concern | i. <input type="checkbox"/> 财务会计 |
| (10) economic entity | j. <input type="checkbox"/> 财务决策 |

Reading One

What Is Financial Accounting?

By Dayna Noffke

There are two primary types of business accounting: managerial and financial accounting. Managerial accounting focuses on interpreting financial information for use within the company to assist managers in making decisions. Managerial accounting reports can be presented in any format, and do not have to adhere to specific accounting principles, except insofar as good practice and ethical standards are followed. Financial accounting follows generally accepted accounting principles (GAAP)¹ and is not used for internal decision-making. One very important distinction between managerial and financial accounting is that a managerial accounting report is future-oriented and addresses the financial needs of the company, while a financial accounting report is based strictly on historical, past financial performance.

Financial accounting is a specific type of accounting that is used by businesses to prepare reports on the finances of a firm for people outside of the organization, such as stockholders or government agencies. It is governed by specific accounting standards to insure uniformity in reporting.

The function of financial accounting is to prepare reliable reports on a business's financial state at any given time. Corporations and other large businesses typically prepare reports on a regular schedule; at a minimum, yearly. A financial accounting report does not interpret, or provide advice on, the financial health of a company. Rather it reports objective financial information in a specific format for the viewer to interpret.

Financial accounting creates a public record of a company's historical financial performance, which allows stockholders and other stakeholders outside of the

organization to get a clear picture of a business's financial health. Because financial accountants must follow a strict set of **accounting principles**, stakeholders can be assured that the information they are receiving is accurate and objective. They can then make predictive **assumptions** on performance and base future **financial decisions** on these assumptions.

If financial accounting is going to be useful, a company's reports need to be **credible**, easy to understand, and comparable to those of other companies. **To this end**, financial accounting follows a set of common rules known as accounting standards or generally accepted accounting principles (GAAP, pronounced "gap").

GAAP is based on some basic **underlying** principles and concepts such as the **cost principle**, **matching principle**, **full disclosure**, **going concern**, **economic entity**, **conservatism**, **relevance**, and **reliability**.

GAAP, however, is not **static**. It includes some very complex standards that were issued **in response to** some very complicated business transactions. GAAP also addresses accounting practices that may be unique to particular industries, such as **utility**, banking, and insurance. Often these practices are a response to changes in government regulations of the industry.

GAAP includes many specific **pronouncements** as issued by the Financial Accounting Standards Board (FASB, pronounced "fas-bee")². The FASB is a non-government group that researches current needs and develops accounting rules to meet those needs.

In addition to following the **provisions** of GAAP, any corporation whose stock is publicly traded is also **subject to** the reporting requirements of the Securities and Exchange Commission (SEC)³, an agency of the U.S. government. These requirements **mandate** an annual report to stockholders as well as an annual report to the SEC. The annual report to the SEC requires that independent certified public accountants audit a company's financial statements, thus giving assurance that the company has followed GAAP.

In order to pursue a career in financial accounting, one must complete an approved program of study to become a CPA, Certified Public Accountant⁴. There are a number of schools that offer Associate degrees in accounting; however, some employers prefer to hire accountants who have completed a Bachelors

degree in Accounting with additional **coursework** in business. All CPAs must pass a licensure exam to qualify to practice as a CPA. The U.S. Bureau of Labor Statistics⁵ states that the job outlook for CPAs is excellent, with above-average job growth, owing to increasing numbers of businesses and “greater **scrutiny** of company finances.”

(654 words)

Notes:

(1) Generally Accepted Accounting Principles (GAAP) 公认会计原则

Generally accepted accounting principles (GAAP) refer to the standard framework of guidelines for financial accounting used in any given jurisdiction; generally known as accounting standards or standard accounting practice. These include the standards, conventions, and rules that accountants follow in recording and summarizing and in the preparation of financial statements.

(2) Financial Accounting Standards Board (FASB) 财务会计准则委员会

The Financial Accounting Standards Board (FASB) is a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles (GAAP) within the United States in the public’s interest. The Securities and Exchange Commission (SEC) designated the FASB as the organization responsible for setting accounting standards for public companies in the U.S. It was created in 1973, replacing the Committee on Accounting Procedure (CAP) and the Accounting Principles Board (APB) of the American Institute of Certified Public Accountants (AICPA).

(3) Securities and Exchange Commission (SEC) 证券交易委员会

The U.S. Securities and Exchange Commission (SEC) is an agency of the United States federal government. It holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation’s stock and options exchanges, and other electronic securities markets in the United States.

(4) Certified Public Accountants (CPA) 注册会计师

Certified Public Accountant (CPA) is the statutory title of qualified accountants in the United States who have passed the Uniform Certified Public Accountant Examination and have met additional state education and experience

requirements for certification as a CPA.

(5) U.S. Bureau of Labor Statistics 美国劳工统计局

The Bureau of Labor Statistics (BLS) is a unit of the United States Department of Labor. It is the principal fact-finding agency for the U.S. government in the broad field of labor economics and statistics and serves as a principal agency of the U.S. Federal Statistical System. The BLS is a governmental statistical agency that collects, processes, analyzes, and disseminates essential statistical data to the American public, the U.S. Congress, other Federal agencies, State and local governments, business, and labor representatives. The BLS also serves as a statistical resource to the Department of Labor.

► Read for Main Ideas

Read the passage carefully and find answers to the following questions.

- (1) What is the purpose of financial accounting?
- (2) What is the distinction between financial accounting and managerial accounting?
- (3) What is GAAP based on?

► Read for Details

Read the passage quickly and decide whether the following statements are True (T) or False (F).

- | | |
|---|--------------------------|
| (1) Financial accounting is a specialized branch of accounting. | <input type="checkbox"/> |
| (2) Financial accounting creates reports to the external users. | <input type="checkbox"/> |
| (3) Financial accounting report is future-oriented. | <input type="checkbox"/> |
| (4) GAAP is active and includes some very complex standards. | <input type="checkbox"/> |
| (5) It's not necessary for people to pass a licensure exam to be qualified as CPAs. | <input type="checkbox"/> |

Task-driven Practice

Task 1. E-C translation

Translate the following sentences from English to Chinese.

- (1) The function of financial accounting is to prepare reliable reports on a business's financial state at any given time.
- (2) Financial accounting follows generally accepted accounting principles (GAAP) and is not used for internal decision-making.
- (3) If financial accounting is going to be useful, a company's reports need to be credible, easy to understand, and comparable to those of other companies.
- (4) GAAP includes many specific pronouncements as issued by the Financial Accounting Standards Board (FASB).
- (5) These requirements mandate an annual report to stockholders as well as an annual report to the SEC.

Task 2. C-E translation

Translate the following sentences from Chinese to English.

- (1) 他们可以对企业的财务业绩进行预测性的假设，并在此基础上作出未来的财务决策。
- (2) 管理会计侧重于解释财务信息供公司内部使用，以协助经理作出决策。

- (3) 为此，财务会计遵循会计准则或公认会计原则等一组通用规则。
- (4) 财务会计准则委员会是一个非政府组织，致力于研究当前所需并制定会计规则来满足这些需求。
- (5) 为能在财务会计领域谋取职位，个人必须完成规定的学习计划，以成为一名注册会计师。

Task 3. Reading Comprehension

The following questions are based on Reading One. Go over the questions first. Then fast read the passage and make the right choices.

- (1) The branch of accounting that focuses on the preparation and presentation of financial statements primarily to external users.
- | | |
|--------------------------|---------------------------|
| a. Financial accounting. | b. Management accounting. |
| c. External auditing. | d. Tax accounting. |
- (2) The branch of accounting that provides information used internally for planning, evaluating, analyzing, and controlling business decisions and operations.
- | | |
|---------------------------|--------------------------|
| a. Internal auditing. | b. Financial accounting. |
| c. Managerial accounting. | d. Forensic accounting. |
- (3) External users of accounting information include _____
- | | |
|------------------|----------------------|
| a. Shareholders. | b. Customers. |
| c. Creditors. | d. All of the above. |
- (4) The primary objective of financial accounting is _____
- | |
|--|
| a. To help company keep track of financing activities. |
| b. To provide financial statements to help users analyze a company's activities. |
| c. To help a company define its ideas, goals, and actions. |
| d. To help a company keep track of its buying and selling of resources. |

- (5) The non-government group that oversees external financial reporting standards is
- Financial Accounting Standards Board.
 - Federal Bureau of Investigation.
 - General Accounting Office.
 - Internal Revenue Service.

Task 4. Mini-presentations

Brainstorm with your partners on What is Your Understanding of Financial Accounting. Make a list of your ideas and present your speech on this topic in a concise and logical manner. Remember your speech will answer the following questions:

- (1) How do you define financial accounting?
- (2) What is the function of financial accounting?
- (3) What principles is financial accounting based on?
- (4) What is the distinction between financial accounting and managerial accounting?
- (5) How can you become a financial accountant?

Task 5. Summarizing

Work with your partners or alone to complete the following summary by translating the Chinese definitions into English.

(1) _____ (财务会计) is a specialized (2) _____ (分支) of accounting that keeps track of a company's financial transactions. Using standardized guidelines, the transactions are recorded, summarized, and presented in a (3) _____ (财务报告) or financial statement such as an income statement or a balance sheet.

Companies issue financial statements on a routine schedule. The statements are considered (4) _____ (外部的) because they are given to people outside of the company, with the primary recipients being (5) _____ (股东), as well as certain lenders. If a corporation's stock is publicly traded, however, its financial statements (and other financial reportings) tend to be widely circulated, and information will likely reach secondary recipients such as competitors, customers, employees, labor organizations, and investment analysts.

It's important to point out that the purpose of financial accounting is not to

report the (6) _____ (价值) of a company. Rather, its purpose is to provide enough (7) _____ (信息) for others to assess the value of a company for themselves.

Because external financial statements are used by a variety of people in a variety of ways, financial accounting has common rules known as accounting standards and as (8) _____ (公认会计原则). In the U.S., (9) _____ (财务会计准则委员会) is the organization that develops the accounting standards and principles. Corporations whose stock is publicly traded must also comply with the reporting requirements of (10) _____ (证券交易委员会), an agency of the U.S. government.

Reading Two

What Are the Four Basic Assumptions That Underlie the Financial Accounting Structure?

By Kathy Adams McIntosh

Financial accounting forms the basis for creating financial statements and communicating financial results to internal and external users of those statements. Four basic assumptions form the basis for the financial accounting structure in businesses. All users of financial statements need to understand the **basic assumptions**¹ used in financial accounting in order to understand what the financial statements are communicating.

■ **Separate Entity**

The separate entity assumption recognizes that the company exists as an entity separate from its owners. The company enters into transactions independently of its owners, manages its own **cash inflows** and **outflows** and communicates directly with **third parties**. Legal actions taken against the company do not involve the owners. Instead the **plaintiff** deals directly with the company or the company's legal staff. The business owner's personal assets and liabilities bear no relationship with the company's **assets**² and **liabilities**³. This allows third parties to enter into agreements with the company confident that the company will **deliver**

on its promises.

■ **Going Concern**

The going concern assumption takes the position that the company will continue to exist indefinitely. There is no end date for the company. Once the company forms, financial statement users can assume that the company will continue to **interact with** customers, investors and vendors into the future. This allows investors to buy and sell company **securities** without fear of the company **liquidating**.

■ **Monetary Unit**

The monetary unit assumption provides reassurance that the financial statements are reported consistently using the same money units each period. **With the advent of** technology and the global marketplace, companies operate in multiple countries using a variety of currencies for their business transactions. **Regardless of** these transactions, the financial statements continue to be created using the monetary unit of the primary country. This allows financial statement users to compare financial statements from various time periods. The monetary unit assumption also provides reassurance that the information reported is **quantifiable** and measured in the appropriate monetary unit. The financial data is based on measurable amounts, not guesses, by the company.

■ **Fixed Time Period**

The fixed time period assumption allows the financial statement user to realize the time period used for financial reporting. Each financial statement includes the date range for which the financial statement applies at the top of the page. Most companies create financial statements quarterly and annually. Some companies create financial statements monthly, although these may be kept for internal use.

(416 words)

Notes:

(1) basic accounting assumptions 会计基本假设

Basic accounting assumptions is a set of standards of rules based on generally accepted accounting principles (GAAP). Accounting principles and assumptions

are the essential guidelines under which businesses prepare their financial statements. Basic accounting assumption may be categorized into four types: economic entity assumption, going concern assumption, monetary unit assumption and time period assumption.

(2) assets 资产

An asset is defined as anything that has value to the business. Assets are reported on the Balance Sheet and are classified as either current assets or non-current assets. Current assets are cash and assets that can typically be converted to cash within one year or operating cycle. Current assets are a component of working capital which is the difference between current assets and current liabilities. Non-current assets are assets that are not as liquid and will likely not be converted into cash in the next year.

(3) liabilities 负债

A liability is a financial obligation of a business. Liabilities are reported on the Balance Sheet and are classified as current and long term. Current liabilities will reduce the assets of the company within one year or operating cycle. Current liabilities are a component of working capital which is the difference between current assets and current liabilities.

Writing

1. Rearrange the following words and phrases to form coherent sentences.

- (1) in businesses/Four basic assumptions/the financial accounting structure/form/the basis for
- (2) that/the company exists as an entity/recognizes/separate from its owners/ The separate entity assumption
- (3) the company/exist indefinitely/takes the position that/The going concern assumption/will continue to
- (4) Once the company forms/can assume that/ the company/financial statement users/will continue to exist
- (5) and annually/create/quarterly/financial statements/Most companies

2. Rearrange the following sentences in logical order to form a coherent passage on Monetary Unit Assumption.

- (1) The assumption fails completely if an entity records transactions in the currency of a hyperinflationary economy.
- (2) The monetary unit principle also assumes that the value of the unit of currency in which you record transactions remains relatively stable over time.
- (3) The monetary unit principle states that you only record transactions that can be expressed in terms of a currency.
- (4) For example, a dollar invested to buy an asset 20 years ago is worth considerably more than a dollar invested today, because the purchasing power of the dollar has declined during the intervening years.
- (5) However, given the amount of persistent currency inflation in most economies, this assumption is not correct.
- (6) Thus, you cannot record such non-quantifiable items as employee skill levels, the quality of customer service, or the ingenuity of the engineering staff.

The correct order: () — () — () — () — () — ()

3. Write an essay within 200 words to express your understanding of the 4 basic accounting assumptions.

Background

Accountants use a range of underlying concepts designed to ensure consistency when preparing company accounts. These include principles as to how accountants should treat the relevant financial data and conventions as to how they should deal with specific issues that may arise. But these are underpinned by four basic assumptions, which are effectively the fundamental basis of any set of accounts.

Achievement Test

After learning this unit, you are required to finish Test One in supplementary material.