

# Explaining basic accounting concepts and business structures



Basic Accounting Concepts and Business Structures The objectives of the essay are to provide appropriate answers to the following:

Topic 1: Identify and describe the sources of generally accepted accounting principles. Identify source hierarchy and explain why the hierarchy is important.

Topic 2: Describe effective accounting information using the qualities of accounting information from your readings this week.

Topic 3: Describe how an accrual based accounting system is different from a cash basis of accounting.

Topic 4: Describe the types of business structures and the defining features of each structure.

Topic 1: Identify and describe the sources of generally accepted accounting principles. Identify source hierarchy and explain why the hierarchy is important.

Generally accepted accounting principles (GAAP) are common set of standards and principles established by an authorized body tasked with designing rules encompassing organizations in a given location and over a specified period of time. The standards and principles should be universal in nature and must be applicable for businesses in the United States; otherwise each and every business enterprise would design their unique set of standards making it difficult for a governing bodies and readers of financial statements to monitor and evaluate adherence and compliance with accounting policies and reportorial requirements. The Financial Accounting Standards Board (FASB) is responsible for designing a standard, known as “The Hierarchy of GAAP” which explicitly details the meaning of GAAP. In this regard, the sources of GAAP are as follows: FASB Standards, Interpretations, <https://assignbuster.com/explaining-basic-accounting-concepts-and-business-structures/>

and Staff Positions; APB Opinions; and AICPA Accounting Research Bulletins. According to Valade (2010, pars. 10 – 12), the general guidelines explaining the rationale and importance of the hierarchy are summed as: “ Level 1 pronouncements are the top level of authority, and take precedence over lower levels of announcements. If an accounting issue is addressed in multiple levels, guidance in the highest level must be followed.

Pronouncements within any level carry equal weight”. In this regard, level 1 or category A in Kieso, Weygandt, & Warfield, 2007, 12) is the most authoritative set of professional bodies but “ if an accounting treatment of an event is not specified by Category A pronouncement, then Categories B through D should be investigated” according to the hierarchical order.

Topic 2: Describe effective accounting information using the qualities of accounting information from your readings this week.

The most effective accounting information depends on the usefulness of the information for decision making purposes. According to Kieso, Weygandt, & Warfield (2007, 31), the FASB itemized qualitative characteristics according to hierarchy: the primary qualities being relevance and reliability; and the secondary qualities are comparability and consistency. Under relevance, the critical ingredients that must be ingrained are predictive value, feedback value and timeliness. Under reliability of accounting information, the data must be verifiable, must have representational faithfulness and be neutral.

The quality of comparability is relevant in according users of accounting information with accurate and comparable basis for identification of similarities and differences in economic events among business enterprises (Kieso, Weygandt, & Warfield (2007, 33). On the other hand, consistency

ensures application of the same accounting treatment across long periods of  
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time.

Topic 3: Describe how an accrual based accounting system is different from a cash basis of accounting.

According to Meigs, Johnson & Meigs (1977, 101 – 102), “ a business which recognizes revenue in the period in which it is earned and which deducts in the same period the expenses incurred in generating this revenue is using the accrual basis of accounting”. On the other hand, under cash basis of accounting, revenue is not recorded until received in cash; expenses are assigned for the period in which cash payment is made. The accrual basis is thus essential to income determination, and the measurement of income is a major objective of the whole accounting process. The cash basis of accounting, on the contrary, does not give a good picture of profitability. It ignores uncollected revenue which has been earned and expenses which have been incurred but not yet paid.

Topic 4: Describe the types of business structures and the defining features of each structure.

A business enterprise may be organized as a single proprietorship, a partnership, or a corporation. As indicated by Kimmel, Weygandt, & Kieso (2007, 4), a single proprietorship is a type of business structure owned by one person. It is simple to establish as controlled only by the owner, and it has tax advantages. It is common for small retail stores, services enterprises, farms, professional practices in law, medicine, and public accounting. (Meigs, et. al., 1997, 10)

On the other hand, a business owned by two or more persons voluntarily associated as partners is called a partnership. It is also simple to establish and pulls the resources and skills of two owners. Partnerships are widely  
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used for small businesses and for professional practice.

Finally, a corporation is a business incorporated under the laws of one of the states, with the owners identified as stockholders. Ownership is evidenced by shares of capital stock which can be sold by one investor to another. The advantages of corporations are the ease of gathering large amounts of money, transferability of shares in ownership, limited liability of owners, and continuity of existence (Meigs, et. al., 1997, 11).

#### References

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Valade, L. G. (2010). Generally Accepted Accounting Principles (GAAP) Hierarchy. Retrieved 03 April 2010.