word **integrity** refers to the following qualities: complete, unbroken, unimpaired, sound, honest, and sincere. Accounting information must have these qualities because of the significance of the information to individuals who rely on it in making important financial decisions.

LO1-5

LEARNING OBJECTIVE
Discuss elements of the system of external and internal financial reporting that create integrity in the reported information.

The integrity of accounting information is enhanced in three primary ways. First, certain institutional features add significantly to the integrity of accounting information. These features include standards for the preparation of accounting information, an internal control structure, and audits of financial statements. Second, several professional accounting organizations play unique roles in adding to the integrity of accounting information. Finally, and perhaps most important, is the personal competence, judgment, and ethical behavior of professional accountants. These three elements of the accounting profession come together to ensure that users of accounting information—investors, creditors, managers, and others—can rely on the information to be a fair representation of what it purports to represent.

INSTITUTIONAL FEATURES

Standards for the Preparation of Accounting Information Accounting information that is communicated externally to investors, creditors, and other users must be prepared in accordance with standards that are understood by both the preparers and users of that information. We call these standards **generally accepted accounting principles,** often shortened to GAAP. These principles provide the general framework for determining what information is included in financial statements and how this information is to be prepared and presented. GAAP includes broad principles of measurement and presentation, as well as detailed rules that are used by professional accountants in preparing accounting information and reports.

Accounting principles are not like physical laws; they do not exist in nature waiting to be discovered. Rather, they are developed by people, in light of what we consider to be the most important objectives of financial reporting. In many ways, accounting principles are similar to the rules established for an organized sport, such as baseball or basketball. For example, accounting principles, like sports rules:

- Originate from a combination of tradition, experience, and official decree.
- Require authoritative support and some means of enforcement.
- Are sometimes arbitrary.
- May change over time as shortcomings in the existing rules come to light.
- Must be clearly understood and observed by all participants in the process.

Accounting principles vary somewhat from country to country. The phrase "generally accepted accounting principles (GAAP)" refers to the accounting concepts in use in the United States. The International Accounting Standards Board (IASB) is currently attempting to establish greater uniformity among the accounting principles in use around the world in order to facilitate business activity that increasingly is carried out in more than one country.

In the United States, three organizations are particularly important in establishing accounting principles—the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), and the International Accounting Standards Board (IASB).

Securities and Exchange Commission The **Securities and Exchange Commission** is a governmental agency with the *legal power* to establish accounting principles and financial reporting requirements for publicly owned corporations. In the past, the SEC has generally adopted the recommendations of the FASB (discussed in the following section), rather than develop its own set of accounting principles. Thus, accounting principles continue to be developed in the private sector but are given the *force of law* since the SEC looks to the FASB to develop accounting standards in the United States.

To ensure widespread acceptance of new accounting standards, the FASB *needs the support* of the SEC. Therefore, the two organizations work closely together in developing new accounting standards. The SEC also reviews the financial statements of publicly owned corporations to ensure compliance with its reporting requirements. In the event that a publicly owned corporation fails to comply with these requirements, the SEC may initiate legal action against the company and the responsible individuals. Thus the SEC enforces compliance with generally accepted accounting principles that are established primarily by the FASB.

Financial Accounting Standards Board Today, the most authoritative source of generally accepted accounting principles is the **Financial Accounting Standards Board.** The FASB is an independent rule-making body, consisting of seven members from the accounting profession, industry, financial statement users, and accounting education. Lending support to these members are an advisory council and a large research staff.

The FASB has compiled all of its standards, and those of its predecessors, in an Accounting Standards Codification. The FASB periodically issues updates to its codification. The codification represents official expressions of generally accepted accounting principles.

The FASB is part of the private sector of the economy—*it is not a governmental agency.* The development of accounting principles in the United States traditionally has been carried out in the private sector, although the government, acting through the SEC, exercises considerable influence.

International Accounting Standards Board When an enterprise operates beyond the borders of its own country, differences in financial reporting practices between countries can pose significant problems. For example, when a company buys or sells products in another country, the lack of comparability of accounting information can create uncertainties. Similarly, cross-border financing, where companies sell their securities in the capital markets of another country, is increasingly popular. Business activities that cross borders create the need for more comparable information between companies that reside in different countries.

As a result of increasing cross-border activities, efforts are under way to harmonize accounting standards around the world. The **International Accounting Standards Board (IASB)** is playing a leading role in the harmonization process. The London-based IASB is an elite panel of professionals with deep knowledge of accounting methods used in the most vibrant capital markets.

The IASB issues *International Financial Reporting Standards (IFRS).* European Union countries, Australia, and Canada, among over 100 other countries, require listed companies to follow IASB standards. Most important, the SEC accepts financial statements prepared using IASB standards from foreign companies that are cross-listed on a U.S. stock exchange. In addition, the American Institute of CPAs (AICPA), which essentially has jurisdiction over private company reporting, accepts either FASB standards or IASB standards as authoritative sources of accounting principles.

In early 2010, the SEC issued a Statement in Support of Convergence and Global Accounting Standards. This SEC statement reaffirms the SEC's belief that a single set of high-quality, global accounting standards is in the best interests of investors, and also reaffirms the SEC's belief that IFRS as issued by the IASB is the set of standards best positioned to fill this role. However, in 2012 the SEC issued an extensive report on requiring U.S. public companies to use IFRS. Although the SEC report concluded that IASB standards are generally viewed as high quality, there remain significant obstacles to adopting IASB standards in the United States, including the IASB's dependence on funding from the major accounting firms. In addition, a number of U.S. companies indicated that adopting IFRS could be among the largest accounting-related costs ever imposed on the private sector.[7]

CASE IN POINT

If the United States moves to IFRS, it likely would require significant changes to accounting systems, controls, and procedures. For example, IFRS requires that an entity account for similar transactions in an identical manner regardless of where the transaction occurs in the entity, a requirement that does not exist under U.S. GAAP. Therefore, if IFRS becomes mandatory for U.S. public companies, companies would have to develop a listing of all of their transactions and how they are accounted for throughout the entity.

[7] United States Securities and Exchange Commissions Office of the Chief Accountant, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers*, July 2012.

Public Company Accounting Oversight Board The **Public Company Accounting Oversight Board (PCAOB)** is a quasi-governmental body charged with oversight of the public accounting profession. The Board was created as a result of the Sarbanes-Oxley Act of 2002 and began operations in the spring of 2003.

The PCAOB has extensive powers in overseeing the accounting profession. As stated earlier in the chapter, any accounting firm wishing to audit a public company must register with the PCAOB. The PCAOB sets auditing standards for audits of publicly traded companies, an activity that previously was performed by the accounting profession. The Board also inspects the quality of audits performed by public accounting firms and conducts investigations and administers penalties when substandard audit work is alleged.

The PCAOB is headquartered in Washington, D.C., and has regional offices in major cities throughout the United States. The PCAOB has five members who serve a five-year term and are eligible to be reappointed once. No more than two members of the Board can be certified public accountants. The Board also maintains a large and well-qualified staff. The PCAOB is funded by a mandatory assessment on publicly traded companies. The assessment is a function of the company's market value relative to overall stock market value in the United States.

Audits of Financial Statements What assurance do outsiders have that the financial statements issued by management provide a complete and reliable picture of the company's financial position and operating results? In large part, this assurance is provided by an *audit* of the company's financial statements, performed by a firm of *certified public accountants (CPAs).* These auditors are experts in the field of financial reporting and are *independent* of the company issuing the financial statements.

An **audit** is an *examination* of a company's financial statements, designed to determine the fairness of these statements. Accountants and auditors use the term *fair* in describing financial statements that are reliable and complete, conform to generally accepted accounting principles, and are *not misleading.*

In the auditing of financial statements, generally accepted accounting principles are the standard by which those statements are judged. For the auditor to reach the conclusion that the financial statements are fair representations of a company's financial position, results of operations, and cash flows, the statements must comply in all important ways with generally accepted accounting principles.

Legislation As discussed previously, Congress passed the Sarbanes-Oxley Act in 2002. Among the more important provisions of Sarbanes-Oxley is the creation of the Public Company Accounting Oversight Board described earlier in this chapter. Another important provision of the Act is to ban auditors from providing many nonaudit services for their audit clients on the assumption that those services interfere with the objectivity required of auditors in rendering opinions regarding financial statements upon which investors and creditors rely. Sarbanes-Oxley also places additional responsibilities on corporate boards of directors and audit committees with regard to their oversight of external auditors, and it places responsibility on chief executive officers and chief financial officers of companies to certify the fairness of the company's financial statements.

LO1-6

LEARNING OBJECTIVE
Identify and discuss several professional organizations that play important roles in preparing and communicating accounting information.

PROFESSIONAL ORGANIZATIONS

Several professional accounting organizations play an active role in improving the quality of accounting information that is used by investors, creditors, management, and others. In addition to the Securities and Exchange Commission, Financial Accounting Standards Board, and International Accounting Standards Board discussed earlier, the American Institute of CPAs, the Institute of Management Accountants, the Institute of Internal Auditors, the American Accounting Association, and the Committee of Sponsoring Organizations of the Treadway Commission are particularly important.

American Institute of CPAs (AICPA) The **American Institute of CPAs** is a professional association of certified public accountants. Its mission is to provide members with the most relevant knowledge, resources and advocacy, thereby enabling members to provide the evolving public interest.[8] The AICPA participates in many aspects of the accounting profession. The AICPA conducts accounting research and works closely with the FASB in the establishment and interpretation of generally accepted accounting principles. In fact, prior to the establishment of the FASB, the AICPA had primary responsibility for the establishment of accounting principles. The AICPA's Auditing Standards Board has developed the standards by which audits of private companies are conducted, and the PCAOB has accepted many of these standards for audits of public companies. The AICPA also issues standards for the conduct of other professional services. Finally, the AICPA is responsible for the preparation and grading of the CPA examination, which is discussed later in this chapter.

Institute of Management Accountants (IMA) The mission of the **Institute of Management Accountants** is to provide a forum for research, practice development, education, knowledge sharing, and the advocacy of the highest ethical and best business practices in management accounting and finance.[9] The IMA is recognized by the financial community as a respected organization that influences the concepts and ethical practice of management accounting and financial management. The IMA sponsors a number of educational activities for its members, including national seminars and conferences, regional and local programs, self-study courses, and in-house and online programs. The IMA offers a certification program—the Certified Management Accountant (CMA). This designation testifies to the individual's competence and expertise in management accounting and financial management.

Institute of Internal Auditors (IIA) With more than 180,000 members in over 170 countries, the **Institute of Internal Auditors** is the primary international professional association dedicated to the promotion and development of the practice of internal auditing.[10] It provides professional development through the Certified Internal Auditor® Program and leading-edge conferences and seminars; research through the IIA Research Foundation on trends, best practices, and other internal auditing issues; guidance through the *Standards for the Professional Practice of Internal Auditing;* and educational products on virtually all aspects of the profession. The IIA also provides audit specialty services and industry-specific auditing programs, as well as quality assurance reviews and benchmarking services.

American Accounting Association (AAA) Membership in the **American Accounting Association** is made up primarily of accounting educators, although many practicing accountants are members as well. The mission of the AAA is to further the discipline and profession of accounting through education, research, and service. The focus of many of the AAA's activities is on improving accounting education by better preparing accounting professors and on advancing knowledge in the accounting discipline through research and publication. An important contribution of the AAA to the integrity of accounting information is its impact through accounting faculty on the many students who study accounting in college and subsequently become professional accountants.

Committee of Sponsoring Organizations of the Treadway Commission (COSO) **COSO** is a voluntary private-sector organization dedicated to providing thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control, and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations.[11] COSO was originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting (chaired by former SEC Commissioner James C. Treadway, Jr.). The National Commission on Fraudulent Financial Reporting studied the causal factors that lead to fraudulent financial reporting and made a series of recommendations for improving financial reporting, auditing, and accounting education. The original sponsors of the National Commission on Fraudulent Financial Reporting, and the current sponsors of COSO, are the AAA, the AICPA, Financial Executives International, the IIA, and the IMA.

8 www.aicpa.org.
9 www.imanet.org.
10 www.theiia.org.
11 www.coso.org.

COSO is best known for its work in developing the standards for evaluating internal control—particularly internal control over financial reporting. As a result of the Sarbanes-Oxley Act, public companies now need to evaluate the effectiveness of their internal control over financial reporting on a yearly basis, as well as have their auditors separately report on the auditors' evaluation of the effectiveness of internal control over financial reporting. The standard for evaluating the effectiveness of internal control over financial reporting is contained in COSO's 2013 publication, *Internal Control–Integrated Framework: 2013.*

COMPETENCE, JUDGMENT, AND ETHICAL BEHAVIOR

LO1-7

LEARNING OBJECTIVE
Discuss the importance of personal competence, professional judgment, and ethical behavior on the part of accounting professionals.

Preparing and presenting accounting information is not a mechanical task that can be performed entirely by a computer or even by well-trained clerical personnel. A characteristic common to all recognized professions, including medicine, law, and accounting, is the need for competent individual practitioners to solve problems using their professional judgment and applying strong ethical standards. The problems encountered in the practice of a profession are often complex, and the specific circumstances unique. In many cases, the well-being of others is directly affected by the work of a professional.

To illustrate the importance of competence, professional judgment, and ethical behavior in the preparation of financial statements, consider the following complex issues that must be addressed by the accountant:

- At what point should an enterprise account for transactions that continue over a long period of time, such as a long-term contract to construct an interstate highway?
- What constitutes adequate disclosure of information that would be expected by a reasonably informed user of financial statements?
- At what point are a company's financial problems sufficient to question whether it will be able to remain in business for the foreseeable future, and when should that information be communicated to users of its financial statements?
- When have efforts by management to improve (that is, "window dress") its financial statements crossed a line that is inappropriate, making the financial statements actually misleading to investors and creditors?

Judgment always involves some risk of error. Some errors in judgment result from carelessness or inexperience on the part of the preparer of financial information or the decision maker who uses that information. Others occur simply because future events are uncertain and do not work out as expected when the information was prepared.

If the public is to have confidence in the judgment of professional accountants, these accountants first must demonstrate that they possess the characteristic of *competence.* Both the accounting profession and state governments have taken steps to assure the public of the technical competence of **certified public accountants** (CPAs). CPAs are licensed by the states, in much the same manner as states license physicians and attorneys. The licensing requirements vary somewhat from state to state, but in general, an individual must be of good character, have completed 150 semester hours of college work with a major in accounting, pass a rigorous examination, and have accounting experience. In addition, most states require all CPAs to spend at least 40 hours per year in continuing professional education throughout their careers.

Management accountants are not required to be licensed as CPAs. However, they voluntarily may earn a **certified management accountant** (CMA) or a **certified internal auditor** (CIA) as evidence of their professional competence. These certifications are issued by the IMA and the IIA, and signify competence in management accounting and internal auditing, respectively. The requirements for becoming a CMA and CIA are similar to those for becoming a CPA.

Integrity in accounting requires honesty and a strong commitment to ethical conduct—doing the right thing. For a professional accountant, ethical behavior is just as important as competence. However, it is far more difficult to test or enforce.

Many professional organizations have codes of ethics or professional conduct that direct the activities of their members. The AICPA, for example, has a code of professional conduct that expresses the accounting profession's recognition of its responsibilities to the public, to clients, and to colleagues. The principles included in the code guide AICPA members in the performance of their professional responsibilities. This code expresses the basic tenets of ethical and professional behavior and is enforced in conjunction with state professional societies of CPAs, although state regulatory boards take precedence in regulating the CPA license.

YOUR TURN — **You as a Professional Accountant**

You are a professional accountant working for a public accounting firm and find yourself in a difficult situation. You have discovered some irregularities in the financial records of your firm's client. You are uncertain whether these irregularities are the result of carelessness on the part of the company's employees or represent intentional steps taken to cover up questionable activities. You approach your superior about this and she indicates that you should ignore it. Her response is, "These things happen all of the time and usually are pretty minor. We are on a very tight time schedule to complete this engagement, so let's just keep our eyes on our goal of finishing our work by the end of the month." What would you do?

(See our comments in Connect.)

Exhibit 1–6 contains excerpts from the AICPA code of professional conduct. One of the principles expressed in the AICPA's code of professional conduct is the commitment of CPAs to the public interest, shown in Article II. The public interest is defined as the collective well-being of the community of people and institutions the profession serves. Other principles emphasize the importance of integrity, objectivity, independence, and due care in the performance of one's duties.

EXHIBIT 1–6
Excerpts from the AICPA Code of Professional Conduct

Preamble

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues.[12] They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

Articles

I. Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

II. The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

III. Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

IV. Objectivity and Independence

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

V. Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

VI. Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

[12] www.aicpa.org.

Expectations of ethical conduct are also important for other accountants. The IMA has a code of conduct for management accountants, as does the IIA for internal auditors.

Users of accounting information—both external and internal—recognize that the reliability of the information is affected by the competence, professional judgment, and ethical standards of accountants. While the institutional features and professional organizations that were discussed earlier are important parts of the financial reporting system, the personal attributes of competence, professional judgment, and ethical behavior ultimately ensure the quality and reliability of accounting information.

In this text, we address the topic of ethical conduct primarily through questions, exercises, problems, and cases that emphasize the general concepts of honesty, fairness, and adequate disclosure. Most chapters include assignment material in which you are asked to make judgment calls in applying these concepts. (These assignments are identified by the scales of justice logo appearing in the margin.)

Careers in Accounting

LO1-8

LEARNING OBJECTIVE
Describe various career opportunities in accounting.

Accounting—along with such fields as architecture, engineering, law, medicine, and theology—is recognized as a profession. What distinguishes a profession from other disciplines? There is no single recognized definition of a profession, but all of these fields have several characteristics in common.

First, all professions involve a complex and evolving body of knowledge. In accounting, the complexity and the ever-changing nature of the business world, financial reporting requirements, management's demands for increasingly complex information, and income tax laws certainly meet this criterion.

Second, in all professions, practitioners must use their professional judgment to resolve problems and dilemmas. Throughout this text, we will point out situations requiring accountants to exercise professional judgment.

Of greatest importance, however, is the unique responsibility of professionals *to serve the public's best interest, even at the sacrifice of personal advantage*. This responsibility stems from the fact that the public has little technical knowledge in the professions, yet fair and competent performance by professionals is vital to the public's health, safety, or well-being. The practice of medicine, for example, directly affects public health, while engineering affects public safety. Accounting affects the public's well-being in many ways, because accounting information is used in the allocation of economic resources throughout society. Thus, accountants have a basic social contract to avoid being associated with misleading information.

Accountants tend to specialize in specific fields, as do the members of other professions. Career opportunities in accounting may be divided into four broad areas: (1) public accounting, (2) management accounting, (3) governmental accounting, and (4) accounting education.

PUBLIC ACCOUNTING

Certified public accountants offer a variety of accounting services to the public. These individuals may work in a CPA firm or as sole practitioners.

The work of public accountants consists primarily of auditing financial statements, income tax work, and management advisory services (management consulting).

Management advisory services extend well beyond tax planning and accounting matters; CPAs advise management on such diverse issues as international mergers, manufacturing processes, and the introduction of new products. CPAs assist management because *financial considerations enter into almost every business decision.*

A great many CPAs move from public accounting into managerial positions with organizations. These "alumni" from public accounting often move directly into such top management positions as controller, treasurer, or chief financial officer.

The CPA Examination To become a CPA, a person must meet several criteria, including an extensive university education requirement, passing the CPA examination, and meeting a practice experience requirement. CPA certificates are granted by 55 legal jurisdictions

(50 U.S. states, Guam, Puerto Rico, the Virgin Islands, Washington, D.C., and the Mariana Islands). The CPA examination is a rigorous examination that covers a variety of accounting and business subjects that allow candidates to demonstrate their knowledge and skills in areas believed important for protecting the public. The exam is computer-based and is offered at many testing centers throughout the United States.

MANAGEMENT ACCOUNTING

In contrast to the public accountant who serves many clients, the management accountant works for one enterprise. Management accountants develop and interpret accounting information designed specifically to meet the various needs of management.

The chief accounting officer of an organization usually is called the *chief accounting officer (CAO)* or *controller*. The term *controller* has been used to emphasize the fact that one basic purpose of accounting data is to aid in controlling business operations. The CAO or controller is part of the top management team, which is responsible for running the business, setting its objectives, and seeing that these objectives are met. For example, only three corporate officers are required to sign the Form 10-K that public companies file yearly with the Securities and Exchange Commission—the CEO, the CFO, and the chief accounting officer (CAO).

In addition to developing information to assist managers, management accountants are responsible for operating the company's accounting system, including the recording of transactions and the preparation of financial statements, tax returns, and other accounting reports. Because the responsibilities of management accountants are so broad, many areas of specialization have developed. Among the more important are financial forecasting, cost accounting, and internal auditing.

GOVERNMENTAL ACCOUNTING

Governmental agencies use accounting information in allocating their resources and in controlling their operations. Therefore, the need for management accountants in governmental agencies is similar to that in business organizations.

The GAO: Who Audits the Government? The **Government Accountability Office** (GAO) audits many agencies of the federal government, as well as some private organizations doing business with the government. The GAO reports its findings directly to Congress, which, in turn, often discloses these findings to the public.

GAO investigations may be designed either to evaluate the efficiency of an entity's operations or to determine the fairness of accounting information reported to the government.

The IRS: Audits of Income Tax Returns Another governmental agency that performs extensive auditing work is the **Internal Revenue Service** (IRS). The IRS handles the millions of income tax returns filed annually by individuals and business organizations and frequently performs auditing functions to verify data contained in these returns.

The SEC: The "Watchdog" of Financial Reporting The SEC works closely with the FASB in establishing generally accepted accounting principles. Most publicly owned corporations must file audited financial statements with the SEC each year. If the SEC believes that a company's financial statements are deficient in any way, it conducts an investigation. If the SEC concludes that federal securities laws have been violated, it initiates legal action against the reporting entity and responsible individuals.

Many other governmental agencies, including the FBI, the Treasury Department, and the FDIC (Federal Deposit Insurance Corporation), use accountants to audit compliance with governmental regulations and to investigate suspected criminal activity. People beginning their careers in governmental accounting often move into top administrative positions.

ACCOUNTING EDUCATION

Some accountants, including your instructor and the authors of this textbook, have chosen to pursue careers in accounting education. A position as an accounting faculty member offers opportunities for teaching, research, consulting, and an unusual degree of freedom in developing individual skills. Accounting educators contribute to the accounting profession in many ways. One, of course, lies in effective teaching; second, in publishing significant research findings; and third, in influencing top students to pursue careers in accounting.

WHAT ABOUT BOOKKEEPING?

Some people think that the work of professional accountants consists primarily of bookkeeping. Actually, it doesn't. In fact, many professional accountants do *little or no* bookkeeping.

Bookkeeping is the clerical side of accounting—the recording of routine transactions and day-to-day record keeping. Today such tasks are performed primarily by computers and skilled clerical personnel, not by accountants.

Professional accountants are involved more with the *interpretation and use* of accounting information than with its actual preparation. Their work includes evaluating the efficiency of operations, resolving complex financial reporting issues, forecasting the results of future operations, auditing, tax planning, and designing efficient accounting systems. There is very little that is "routine" about the work of a professional accountant.

A person might become a proficient bookkeeper in a few weeks or months. To become a professional accountant, however, is a far greater challenge because this requires more than understanding the bookkeeping systems. It requires years of study, experience, and an ongoing commitment to keeping current.

We will illustrate and explain a number of bookkeeping procedures in this text, particularly in the next several chapters. But teaching bookkeeping skills is *not* our goal; the primary purpose of this text is to develop your abilities to *understand and use* accounting information in today's business world.

ACCOUNTING AS A STEPPING-STONE

We have mentioned that many professional accountants leave their accounting careers for key positions in management or administration. An accounting background is invaluable in such positions, because top management works continuously with issues defined and described in accounting terms and concepts.

An especially useful stepping-stone is experience in public accounting. Public accountants have the unusual opportunity of getting an inside look at many different business organizations, which makes them particularly well suited for top management positions in other organizations.

BUT WHAT ABOUT ME? I'M NOT AN ACCOUNTING MAJOR

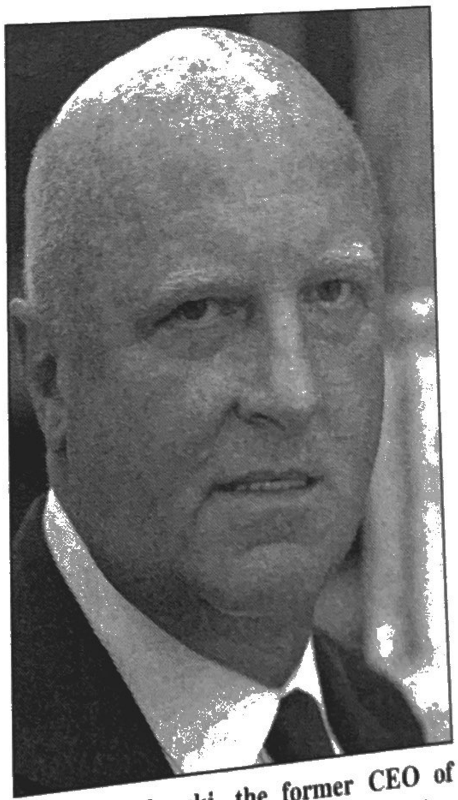
Most students who use this book are not accounting majors. However, the study of accounting is still important to you. You need to understand accounting concepts, both for your professional career and for many aspects of your personal life. Accounting is the language of business, and trying to run a business without understanding accounting information is analogous to trying to play sports without understanding the rules. Finance students need to understand accounting concepts if they seek positions in investment banking, consulting, or in corporate America as financial analysts. It is common for chief financial officers of large U.S. corporations have a background in accounting. A management student seeking a career as a management trainee—with the ultimate goal of running a corporation or a corporate division—needs to understand accounting in order to be able to run, control, and evaluate the performance of a business unit. For example, the CEO, who holds the top management position, must certify the accuracy of the company's financial statements on a quarterly and yearly basis. The Sarbanes-Oxley Act imposes severe civil and criminal sanctions on CEOs who certify their company's financial statements if the CEO knows, or should have known, that the financial statements are materially misstated. Marketing students often take positions in sales. It is imperative that marketing students understand the principles of revenue recognition, as well as the obligations of a public company under the U.S. securities laws. A lack of this understanding has led many a marketing/sales executive to become involved in improper revenue recognition schemes. Many of these executives have been subject to civil and criminal prosecution.

ETHICS, FRAUD, AND CORPORATE GOVERNANCE

The early 2000s was a time of unprecedented business failures amid allegations of fraudulent financial reporting that include corporations that have now become household names—**Enron, WorldCom, HealthSouth, Adelphia Communications, Tyco,** and **Qwest**, among others. These problems are not exclusively a problem with financial reporting in the United States, as evidenced by fraud allegations at **Parmalat**, a large Italian company.

Fraud typically is perpetrated by senior management; for example, a 2010 study indicates that the company's chief executive officer and/or chief financial officer is involved in 89 percent of the fraud-related enforcement actions brought by the Securities and Exchange Commission. Committing fraud, an illegal act, obviously suggests a serious lack of ethical awareness and ethical sensitivity on the part of the perpetrators. Another feature of many frauds is that the company where the fraud occurred had a weak corporate governance environment. **Corporate governance** entails corporate structures and processes for overseeing the company's affairs, including oversight by the board of directors of the actions of top management to ensure that the company is being managed with the best interests of shareholders in mind.

In each chapter, we will discuss common fraud-related schemes relevant to the material covered in that chapter, ethical quandaries and challenges faced by businesspeople, or efforts to improve corporate governance and by extension the quality of accounting information in the United States.



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Dennis Kozlowski, the former CEO of Tyco, leaves court upon his conviction for conspiracy, securities fraud, and falsifying records. Kozlowski was sentenced to 8⅓ to 25 years in prison. A failure to understand and apply securities laws exposes management to great personal and professional risk.

Finally, accounting knowledge is helpful in many aspects of your personal life. Accounting concepts are integral to such everyday decisions as personal budgeting, retirement and college planning, lease versus buy decisions, evaluation of loan terms, and evaluation of investment opportunities. Since accounting skills are designed to help you make better economic decisions, you will be using these skills for the rest of your life. The only question is the degree of skill with which you will apply these concepts. Unfortunately, there is substantial evidence that most Americans have a low level of skill when it comes to applying accounting or financial concepts. For example, a recent study by the Securities and Exchange Commission found that "retail investors have a weak grasp of elementary financial concepts and lack critical knowledge of ways to avoid investment fraud."[13]

Concluding Remarks

In this chapter, we have established a framework for your study of accounting. You have learned how financial accounting provides information for external users, primarily investors and creditors, and how accounting provides information for internal management. We have

[13] U.S. Securities and Exchange Commission, *Study Regarding Financial Literacy Among Investors*, August 2012.