

32.14: Putting It Together- Accounting and Finance

Synthesis



Whether or not this module convinced you to pursue a career in accounting, by now you have acquired a working knowledge of some of the basics of financial accounting, as well as the importance of accuracy in the presentation of financial information to stakeholders. Whether you are running a bake sale or a multinational corporation, understanding the relationship between revenues and expenses is critical for success. The misdeeds of corporate executives and their accountants have peppered the news for the last decade; but, the vast majority of accountants and their clients follow a strict code of ethics and observe the laws and guidance provided by Congress, FASB, and AICPA. One of the best ways to protect yourself and your business against becoming involved in a financial scandal is to have a solid working knowledge of basic accounting principles so that you can recognize and correct any irregularities.

Summary

Accounting in Business

In short, accounting is the language of business—all business. Accounting represents all of the financial transactions of a business in a format that can be interpreted and understood by both internal and external stakeholders.

Key Financial Statements

When businesses present their financial condition to external stakeholders, taxing authorities, investors, and the general public, the most common format for this information is one of four key financial statements. These four statements are the Balance Sheet, Income Statement, Statement of Owners Equity, and Statement of Cash Flows. These four statements, although representing different facets of the company's finances, are all interconnected and create a birds-eye view of the company's financial position.

Break-Even Point

Businesses, both large and small, are concerned with determining the point at which their revenues exceed their expenses and they begin to make a profit. The point at which revenue equals expenses (and profit is therefore \$0) is called the break-even point.

Financial Ratios

Financial ratios allow business to represent the relationships between components of their financial operations as ratios. Financial ratios are used to measure a firm's financial health in four areas: liquidity, long-term solvency, profitability tests, and the market. These ratios can be used to compare the company's performance across periods (months, quarters, years) or to similar companies within the same industry.

Ethical Practices in Accounting

Certified public accountants (CPAs) and certified management accountants (CMAs) are bound to the Code of Ethics established by their licensing bodies. Generally accepted accounting principles (GAAP) and the Financial Accounting Standards Board (FASB) have established practices designed to ensure that the financial status of a company is "fairly and accurately" presented. Legislation such as the Sarbanes-Oxley Act has been passed by Congress to strengthen the emphasis on ethical practices in accountancy. Although stories of unethical conduct by companies such as Enron, WorldCom, and HP have made headlines, the overwhelming majority of individuals working as internal or external accountants follow the code of ethics and work hard to ensure that the information provided to stakeholders is fair and accurate.

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