Accounting Principles

History
Accounting and the double-entry system was founded by a Christian monk named Luca Pacioli in 1494. Goethe called it “one of the finest discoveries of the human intellect.”

Principles
Every economic event has at least two aspects:
- Debits
- Credits
- Effort/Sacrifice (Expense)
- Reward/Benefit (Revenue)
- Useful things (Assets)
- Source of ownership (Equity and Debt)

Hierarchy of Generally Accepted Accounting Principles (GAAP)

Knowledge: FASB statements and APB opinions
Interpretation: FASB interpretations of principles
Application: Technical Bulletins

Handlers of information
- Assemble: Management gathers, records, summarizes, and classifies information on statements.
- Analyze: Analysts use information to identify strengths and weaknesses.
- Evaluate: Investors and creditors use the information to make decisions.

Authorities
1. Securities and Exchange Commission
   a. 1933 act requires full financial disclosure for initial stock offering
   b. 1934 act requires faithful reporting and audits for traded securities to prevent fraud, misrepresentation and deceit
2. Financial Accounting Standards Board (FASB)
   a. Seven full-time members produce standards for public corporations
Sarbanes-Oxley has now instituted the Public Company Accounting Oversight Board and provides penalties for fraud, CPA consulting restrictions, and management duties
3. FASAB produces standards for the Federal government
4. GASB produces standards for state and local government (and not-for-profit)

Conventions
- Materiality: Pennies don’t matter to most, hundreds don’t to a large company
- Cost-benefit: Is work and expense of accounting worth it (Sarbanes-Oxley?)
- Comparable: All companies follow the same set of principles
- Consistent: No changes in principles or applications from period to period
- Conservatism: Choose accounting least likely to overstate assets and income
- Full disclosure: Present all information relevant to user’s understanding

Concepts
- Historical cost: Carry asset on the books at what was paid or given for it
  - Exceptions are impaired assets and marketable investments
  - Matching revenues and expenses in a time period
    - What is given up (expense) to produce what is received (revenue)

Accounting is:
1. Assembling: Source documents such as invoices, checks, orders.
2. Recording: in journals (like a diary)
3. Organizing: in ledgers with individual accounts
5. Interpreting: Analysts help investors and creditors with decisions

Accounting should strive to be:
- Reliable: faithful to represent reality and able to be verified
- Relevant: timely and with predictive (future) and feedback (past) value