**GAAP Basics**

***The Four Basic Assumptions of Accounting***

* **Economic or Separate Entity**: The company is treated as a separate economic entity for accounting purposes, even if it isn't a separate legal entity.
* **Monetary Unit:** The only business transactions recorded are those in financial terms (dollars and cents in the U.S.).
* **Time Period:** Financial reports cover a specific period of time.
* **Going concern**: Financial reporting assumes, unless otherwise known, that the business will continue operating indefinitely.

***The Four Principles of Accounting***

* **Historical Cost:** Initial recording of financial transactions must be at their original cash equivalent cost.
* **Full Disclosure:** Financial statements contain enough information that they are not misleading.
* **Revenue Recognition**: A company records revenue in the accounting period when services are completed or goods are delivered to the customer, not when the customer makes payment.
* **Matching**: A company records expenses in the accounting period in which it helped create revenue, not when payment was made for the expenses.

***The Four Constraints of Accounting***

* **Materiality**: Should purchases of assets be expensed or depreciated? Theoretically, an asset expected to last four years would be depreciated over four years. However, if the asset cost is immaterial, for example $30, expensing the $30 may be acceptable.
* **Conservatism**: If a company could equally use more than one accounting method, the company should use the one that affects the financial statements in the least favorable immediate way.
* **Cost-Benefit**: Cost-benefit analysis compares the outflows of resources needed to create additional inflows of resources. The benefits should outweigh the costs.
* **Industry Practice**: Some industries have unique requirements, and companies in those industries can follow standard industry practices.