

Generally accepted accounting principles (GAAP), created with authoritative support, are principles, rules and guidelines required to follow by accountants when preparing financial statements. The hierarchy of GAAP is a structure consists of four different categories of well-developed accounting principles. The categories are from A to C with the most authoritative support and category C being the least. (also known as The Hierarchy of GAAP are FASB Standards, Interpretations, and Staff Positions, FPA Consensus, and IACPA Accounting Research Bulletin. The hierarchy is important because it prevents the financial data from being less and inconsistent by using multiple sources of the GAAP instead of just one. For example, if two or more sources in a given category do not agree with a specific transaction, then a higher category should be followed.

Two primary qualities that make the accounting information effective are relevance and reliability. Relevant information has predictive value, which help users forecast the outcome of events in the past, present, and future. Another reason why relevant information is effective is because it is presented in a timely manner that is early enough for the user to consider when making a decision. It also help users confirm and adjusted expectations in the past because relevance information has feedback value. Timeliness is another quality that makes the accounting information effective. Reliable information is verifiable, it represents what really happened, and it's unbiased. Comparability and consistency are two secondary qualities that make accounting information useful. Comparability gives users the ability to compare information between companies in the same industry to make their business decisions. Consistency is another important quality for accounting information to be effective. Consistent accounting information compared over different time periods within one company are useful for users when making business decisions. With that said, all these qualities that makes accounting information high, could only be useful for decision making if the users fully understand it. For example, even if the information presented is reliable, consistent, and relevant, but to a user who does not understand it, the information becomes useless.

An accrual-based accounting system records transactions when an event occurred. For example, comparing using accrual basis accounting system would record their expense and treat earned even if they did not actually get pay yet. This is known as the revenue recognition principle and it's under GAAP. These companies also treat their expenses in the same manner, they record their expenses when it occurs, rather than when the expenses is paid. This principle is called the matching principle, which is also under GAAP. Unlike the accrual basis accounting system, the cash-basis accounting system does the opposite. Companies using this system recognized their earnings when they receive the cash, likewise with their expenses, it is only recognized and recorded once the expenses are paid. Because the cash-basis accounting system violates the revenue recognition and matching principle, it's prohibited under GAAP. Companies using different accounting system should generally different financial statements since the revenues and expenses are recorded in two different time frames.

There are three types of business structures, sole proprietorship, partnership, and corporation. Sole proprietorship is a business owned by one person and it's easy to set up. The owner has complete control of the business. They pay taxes twice compared to corporations, but they are responsible for all debts of their business. The