

Origins and Ethics

by Sophia



WHAT'S COVERED

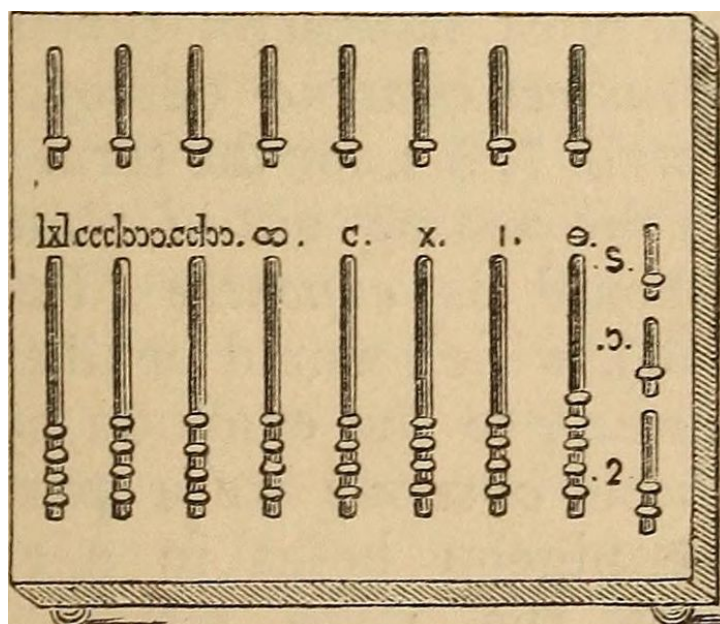
This tutorial will cover the origins of accounting, as well as the purpose, roles, uses and ethical principles related to accounting.

Our discussion breaks down as follows:

1. History of Accounting

We will begin our lesson by discussing how **accounting** started and how it evolved to its current state today. Believe it or not, accounting dates back more than 7,000 years to the Mesopotamian and Babylonian empires. However, it really started to take shape around the 15th century in Italy, where an Italian monk named Luca Pacioli documented the double entry accounting system, involving debits and credits, which is still used today.

Luca Pacioli created the first how-to book on bookkeeping--essentially, the Renaissance version of *Bookkeeping for Dummies*. Below is an image of an abacus, a tool that would have been used by Italian merchants to track the money coming in and out during the 15th century.



So, how far have we come since the time of Luca Pacioli? Well, modern accounting is done primarily through the use of computer software, utilizing any number of different software packages that are available. It is much

less of a manual process than it was back in the 15th century, so we've come quite a long way in accounting.

As accounting has evolved, so has its definition. In modern terms, accounting is an academic discipline, involving the reporting, interpretation, and organization of a financial structure for business.



TERM TO KNOW

Accounting

Academic discipline involving the reporting, interpretation, and organization of a financial structure for a business.

2. Reasons for Accounting

So, why do we really need accounting? Well, accounting is the language of business. It tells the story about a business's current and future performance. It also documents a business's resources. It does this in two ways:

- It measures the available resources, informing a business how much cash it has and how much money is owed to creditors. It can help a business analyze their performance results.
- It allows a business to control the resources that are available for its use. Accounting is an important tool for owners and management to use to track the flow of money into and out of the business. Accounting is necessary in order to operate a business effectively.

3. Roles and Uses of Accounting

There are two main environments in which accounting is used. The first one is the internal environment, referring to an organization's internal users. These people inside an organization use accounting to track and control resources, like cash and equipment, as mentioned earlier. In addition, they use accounting in the following ways:

- Making projections/long-range planning
- Strategically
- Decision-making

The second environment is external, referring to those people external to an organization. They use accounting because they need to know how a business is performing in order to make investing decisions.



HINT

You'll notice the keyword "decisions" appeared in the use of accounting in both internal and external environments. Those internal and external users both use accounting in order to make the appropriate decisions.

It's important to note that accounting is everywhere. We use it in our daily lives, in such tasks as balancing our checkbooks and paying our taxes. There are certain regulatory requirements, such as those that require publicly traded companies to report in certain ways and at periodic intervals. All corporations, as well as individuals, must file taxes, and without accounting, these requirements cannot be met.

The last area to cover is the intersection of math, marketing, and accounting. How are these related? Well, as

discussed, accounting is an integral part of every business, and it relies heavily on math for calculations. Therefore, when using day-to-day accounting, we have to perform a lot of mathematical calculations.

Marketing and marketers try to tell the story of a product so that people will purchase it. Similarly, accounting and accountants try to tell the story of a business so that people will invest in it. As you can see, all three concepts are quite interrelated.

4. Ethics

Why are ethics an issue in accounting? Well, accountants control access to important financial information. In addition, they are under pressure to meet certain expectations, such as performance goals, bonuses, etc. In some cases, the driving force behind accounting practices is simply greed, as was the case in the frauds discussed below.

IN CONTEXT

Our first example involves a company called Enron, which may sound familiar. Enron intentionally reported higher profits and created fictitious companies to hide their debt. Essentially, they made it appear as though they were doing much better than they actually were. When they were exposed, they ended up going bankrupt.

Our second example, WorldCom, also intentionally reported higher profits. In addition, they reported items that should have been expensed--and hence reduced the amount of profit reported--as assets. Therefore, they made the company appear to be in a much better financial position than they actually were.

Effective reporting relies heavily on strong ethics. People need to be able to trust that the information they are being provided with is valid and correct. So, what is being done to protect the profession? Well, one major stride to protect the profession is a law that was enacted in 2002, known as Sarbanes-Oxley, or "SOX" for short. This law requires additional work and investigation surrounding the accuracy of financial reporting. It also forces management to be individually responsible for the accuracy of their financial information. All the CEOs and CFOs of these publicly traded companies are required to sign off that their financial information is complete and correct.



SUMMARY

Today, we learned about the **history of accounting**, beginning with its ancient roots more than 7,000 years ago. We learned how it really started to take shape with Italian monk Luca Pacioli around the 15th century and its evolution to its modern day role as a measurement, control, and communication tool for businesses.

We learned about the **reasons for accounting**, how it tells the story about a business's current and future performance, as well as documents a business's resources. We discussed the different **roles and uses of accounting**, including how it improves decision-making, both for internal and external users, and how it is used by both business and individuals.

Lastly, we learned that accounting is heavily influenced by the **ethics** of individuals, and that measures

such as the Sarbanes-Oxley law are put in place to ensure effective reporting and protect the profession.

Source: Adapted from Sophia instructor Evan McLaughlin.



TERMS TO KNOW

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