

# BASIC ACCOUNTING PRINCIPLES FOR LAWYERS

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# BASIC ACCOUNTING PRINCIPLES FOR LAWYERS

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Third Edition

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University of Nebraska College of Law*



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MATTHEW  BENDER

## *Dedication*

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*To Raelyn, Payton, Quinten, Lofton, and Jordan, the five most wonderful grandchildren anyone could possibly have. My time with all of you is pure joy.*

*To my wife Sandy, for being willing to put up with someone like me on a daily basis and for making each day of my life better than it would have been without her.*

*Finally, to my mother for always being there when I needed her as a child, and for giving me a model of what humanity ought to be.*



## *Preface to the Third Edition*

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*“Money is always on the brain so long as there is a brain in reasonable order.”*

—*Samuel Butler*

Each edition of this book seems to precipitate a major crisis involving accounting. The first edition was published in 1997; less than four years later Enron filed for bankruptcy, taking down the Arthur Andersen accounting firm with it. The second edition was published in 2008, shortly before the 2008 financial crisis. I hope the third edition doesn't continue this escalating trend but, just in case, you should probably stockpile food and invest in gold.

You should also learn something about accounting. If nothing else, these events demonstrate how important it is for lawyers to have a basic understanding of accounting principles.

Significant changes have occurred since the second edition. Justin Bieber has replaced Paris Hilton as the least talented celebrity. The Financial Accounting Standards Board (FASB) has codified generally accepted accounting principles. Congress passed the Dodd-Frank Act to “solve” the 2008 crisis, just as the Sarbanes-Oxley Act “solved” the previous problems. (With Congress at the helm, I'm sure everything will work perfectly from now on.)

Some expected changes have not occurred. When I finished the second edition, I assumed the third edition would discuss the SEC's adoption of international accounting standards, or at least present a timetable for that adoption. But the move toward international standards has slowed, at least in the United States. Nevertheless, the current audit and fraud issues involving Chinese companies show that, not only are international issues unlikely to disappear, their importance is magnified in our increasingly interconnected world.

This edition of the book builds on the two earlier editions, so everyone I thanked in the prefaces to the first two editions deserves continued thanks, especially Gary Adna Ames, who helped build the foundation on which this edition rests. I also want to thank Brad Pesicka, Kevin McVoy, Lucy Li, Sarah Safarik, and the NSA for reading and commenting on this edition. (The NSA didn't provide any comments, but I'm sure they read it.) Kevin, I'm sorry I didn't find the old files sooner; it would have made your work much easier. Finally, my gratitude (and love) to Sandy Placzek for being there when I need her, even if the need is for her to read a draft of a boring accounting book.

Any errors in this book are, of course, the fault of Congress.

C. Steven Bradford





## *Preface to the Second Edition*

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*“I was never a certified public accountant. I just had a degree in accounting. It would require passing a test, which I would not have been able to do.”*

—Bob Newhart

Much has happened since the first edition of this little book was written. Paris Hilton became famous.<sup>1</sup> Enron collapsed, taking the Arthur Andersen accounting firm with it. Congress passed the Sarbanes-Oxley Act to “solve” the problem.<sup>2</sup>

In addition to the people I thanked in the first edition of the book, my thanks to my mother, for showing reprints of everything I have ever written to the only other lawyer she knows,<sup>3</sup> to Justin Barager for his research assistance, and to Sandy Placzek, who has kept me sane<sup>4</sup> while I tried to update this book, serve as President of the University of Nebraska-Lincoln Faculty Senate,<sup>5</sup> and find the perfect Mexican restaurant.<sup>6</sup>

Finally (and sadly), my co-author on the first edition of this book, Gary Adna Ames, is no longer with us. He’s still alive, if you can call living in Rexburg, Idaho “alive.” But he’s no longer a co-author of the book — something to do with the libel suits arising from the first edition. I owe a great debt to Gary for his work on the first edition; his contributions remain evident throughout the book (including especially any libelous material).

C. Steven Bradford

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<sup>1</sup> Or infamous. (Not that she would know the difference.)

<sup>2</sup> That’s the Enron problem, not the Paris Hilton problem. So far, Congress has done nothing to solve the Paris Hilton problem. Apparently, even Congress isn’t willing to tackle some problems.

<sup>3</sup> I won’t tell you where Mom lives; she wants to keep her neighborhood relatively lawyer-free.

<sup>4</sup> It’s a relative term.

<sup>5</sup> That ought to tell you something about the collective judgment of the University of Nebraska faculty.

<sup>6</sup> Two out of three isn’t bad.



## *Preface to the First Edition*

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It isn't easy to write about accounting. Most people prefer disease, pestilence, and even law school to reading about accounting. Many accounting books go out of their way to encourage this attitude; they are boring, pedantic,<sup>7</sup> and humorless. The main lesson they teach about accounting is that it's something to be avoided at all cost.

We've tried to make this book interesting and understandable for law students who have no desire to become accountants. One of us (Professor Bradford) has little formal training in accounting. He remembers what it was like to encounter this subject for the first time. The other (Professor Ames) teaches introductory accounting to undergraduates. He's constantly reminded of what it's like for students to encounter this subject for the first time.

We've tried to transform accounting concepts into clear, conversational English and to inject some humor into the subject. Accounting is dry enough; we see no reason to make it drier. And we've limited the scope of the book to the basic details that every lawyer and law student should know. This is not a treatise on accounting but a relatively short introduction to the essentials.

Our book is designed to be used for a short mini-course on accounting, or as a supplement in courses that touch on accounting issues. It is not intended to be used as the primary text for the typical two or three-credit law and accounting course, although it could be used as a supplement in such a course.

Professor Bradford thanks his colleagues at the University of Nebraska College of Law for their contributions to this book. In their defense, they try to stop his silliness, but consistently fail. Professor Bradford also thanks his wife Meg and his four wonderful children — Jason, Allison, John, and Anne. They realize Daddy is a little goofy, but they put up with him anyway. They in turn inspire Daddy to accomplish what little he accomplishes. Meg deserves a special thanks for her valuable comments on the manuscript.

Professor Ames thanks Professor Bradford, who first had the idea to write this book (and who, therefore, deserves most of the blame). He also thanks his wife Lynn and his seven (that's right, SEVEN) children: Daniel, Jessica, Tyler, Jacob, Stephen, Carly, and Rachel. Without them, his life would be as dull and drab as every other accountant's. Because of them, he has great happiness and a longer dedication than he otherwise would have had.

Both of us are grateful to Meg Bradford, Thomas R. Craig, Bill Lyons, and Steve Willborn for reading the manuscript of this book. Their comments have made the book better. We thank the people at Anderson Publishing for helping to make this book a reality. When we first contacted them, the book was nothing more than a vague idea in our minds; Anderson helped to turn that idea into a reality. Given the state of our minds, that's quite an accomplishment. We also appreciate their patience in waiting for us to finish.

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<sup>7</sup> We promise this is the last word we'll use that we had to look up to verify its meaning.

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*Preface to the First Edition*

Finally, this has been a cooperative effort. Each author would like to stress that any faults in this book are solely the responsibility of the other.

Steve Bradford

Gary Adna Ames

## Using This Book

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*“If the subject matter isn’t inherently interesting — accounting comes to mind — I’ve got to make it amusing, if only to keep myself awake.”*

—Allan Sloan

### Key Concepts to Remember

A text box at the end of each chapter contains key concepts to remember. This box is not intended as a substitute for reading the chapter, but to help you recall key points.

### Glossary

A glossary appears at the end of the book. It defines many of the terms used in the book.

### Footnotes

This book contains many footnotes, but don’t feel obligated to read them. The footnotes in this book aren’t like the footnotes in casebooks and law reviews. You can skip my footnotes and not miss anything important.<sup>8</sup> The footnotes in this book are of three types: (1) humorous comments; (2) citations; and (3) anal-retentive stuff.

1. *Humorous Comments.* These are the most important footnotes. In this book, I make fun of accounting, accountants, law students, professors, and everyone else I could think of to offend.<sup>9</sup> Where my attempts at humor would have broken up the text, I have relegated them to the footnotes. Read these footnotes to remain sane as you learn accounting.

2. *Citations.* Unlike the authors of law review articles, I haven’t provided a citation for everything I say including the meaning of the word “the.” I usually only provide a citation when I’m directly quoting or otherwise owe a special debt to a particular source. You can ignore the citation footnotes unless you’re a law review editor and want to check their form, which is usually wrong.

3. *Anal-Retentive Stuff.* Occasionally, the footnotes contain qualifications or explanatory material that I thought some anal-retentive people might demand. These footnotes aren’t essential to understanding the basic principles in the text, but they make the book appear more intellectual so your law professor will require you to buy it. I sometimes begin these footnotes by telling you not to read them. If you’re as anal-retentive as I am,<sup>10</sup> feel free to read them. If not, ignore them.

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<sup>8</sup> On second thought, perhaps the footnotes in this book *are* like the footnotes in casebooks and law reviews.

<sup>9</sup> If I left anyone out, please let me know, and I will try to offend them in a future edition.

<sup>10</sup> I doubt it. I was voted the Anal-Retentive Law Professor of the Year, which is akin to being the filthiest pig in the sty.



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