

Bookkeeping Tips

What does GAAP really mean?

Generally Accepted Accounting Principles (GAAP) are the body of concepts, principles and procedures developed primarily by the Financial Accounting Standards Board (FASB). The three main sources for GAAP are:

1. FASB pronouncements (statements);
2. Security and Exchange Commission (SEC) regulations for listed companies; and
3. accounting practices developed by respected industries and by public and private bodies over time.

GAAP apply to all entities, including not-for-profit, publicly traded, closely held, corporations, partnerships, sole proprietorships, etc.

The FASB

The FASB comprises seven full-time members who must give up their association with employers and serve a five-year term with one five-year renewal permitted. Members represent segments of the business world, such as financial statement preparers, users and analyzers. Not all members are CPAs. The FASB procedure is to:

1. Appoint a task force to coordinate the topic
2. Prepare a discussion memorandum to identify problems and possible solutions by citing various issues involved
3. Hold a public hearing to get a wide range of feedback
4. Analyze oral and written responses to the discussion memorandum
5. Issue an exposure draft proposing a statement of financial accounting standards
6. Hold a public hearing on the proposed statement
7. Analyze oral/written responses to the exposure draft
8. Issue a final statement of financial accounting standards.

The process forces FASB members to carefully consider different viewpoints and to justify their conclusions, not merely to reach a quick decision.

Five positive votes are needed to pass a "statement of financial accounting standard," which is issued after deliberation and input from any interested parties and includes an appendix with background material on that topic and the reasons behind the FASB's conclusions.

To date, the FASB has issued approximately 150 standards. Some amend or modify existing standards and some are highly specialized, such as for specific industries. Most standards apply universally and have an important effect on financial statements.

(continued)

GAAP is established for state and local governments by the Governmental Accounting Standards Board (GASB), and for the federal government by the Federal Accounting Standards Advisory Board (FASAB).

Basic GAAP Concepts

GAAP include accounting rules (for bad debts, inventory, depreciation, leases, pensions, deferred taxes, intangible assets, bonds, equity, etc.), and principles, such as for materiality, measurement and disclosure.

Materiality is related to whether an item's magnitude makes a difference to a decision maker. If an acquired asset is expected to last for three years, theoretically it should be capitalized and depreciated over three years. But if the asset costs \$25, the amount is so small it is considered *immaterial* and most companies would simply expense the \$25 in the current year.

Consistency means that accounting methods should not be changed from period to period. This permits financial statements to be compared over time. For example, the company should use the same depreciation, inventory costing and other methods from one year to the next so that depreciation and inventory costs can be compared among different years. An entity can change accounting methods if it follows established procedures and discloses the changes in the financial statements.

Conservatism requires that if more than one accounting method is equally defensible, the one resulting in the least immediately favorable impact on the financial statements be used. This will mean that losses that are probable but have not yet occurred are recognized, but gains that are probable are not recognized until they have occurred.

Stable dollar means ignoring inflation in traditional accounting.

Going concern means that, absent information to the contrary, it is assumed a business will last indefinitely. This assumption permits recording accruals and deferrals as revenues/expenses without actual cash flow in the same period. Realization of cash is usually assumed.

Disclosure requires that sufficient information be provided in financial statements to ensure that they are not misleading. The information may be included on the face of statements or in the footnotes, which are considered an integral part of the financial statements

Income tax laws

Created by Congress and Treasury Department Regulations, and enforced by the IRS, tax laws are part of the Internal Revenue Code and primarily focus on raising revenues for the Government. GAAP is concerned with fairly presenting an entity's financial position (balance sheet), operations (income statement and changes in stockholders' equity), stable dollar, and going concern.

BOOKKEEPING TIPS is a free e-letter published by The American Institute of Professional Bookkeepers (www.aipb.org). To subscribe: Send a blank email to bookkeepingtips-on@aipb.org

Contact information: AIPB. Suite 500, 6001 Montrose Road, Rockville, MD 20852.
Tel.: 800-622-0121, Fax: 800-541-0066, email: info@aipb.org. Web site: www.aipb.org

The American Institute of Professional Bookkeepers (AIPB), is the national association for bookkeepers, currently with 30,000 active members

AIPB was founded in 1987 for the following purposes:

- To recognize bookkeeping as a profession—and bookkeepers as professionals

(continued)

- To make sure that each member has the latest bookkeeping, accounting and tax information
- To answer members' everyday bookkeeping and accounting questions on the telephone at no charge.
- To provide bookkeepers with low-cost continuing professional education.
- To return the membership fees of any bookkeeper who is dissatisfied with the benefits of membership