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Generally Accepted Accounting Principles (GAAP)

<u>Accouting: Definition and Necessity</u>

This presentation contains information, in addition to the material prepared and provided by the professor, from:

1. Financial Accounting, David Spiceland, 6th Ed., McGraw-Hill
2. Intermediate Accounting, David Spiceland, 11th Ed., McGraw-Hill
3. Intermediate Accounting, Donald Kieso, 18th Ed., Wiley
4. Other: Official Websites

Generally Accepted Accounting Principles (GAAP)

Definition and Necessity

- Guidelines for measuring and reporting the information in the Financial Statements and Notes.
- Facilitates decision making.
- Provides comparability.
- Necessary tool in capital market transactions.

Development of Financial Accounting and Reporting Standards

HIERARCHY OF US GAAP SETTING

Congress of US

SEC

Private Sector

CAP, APB, FASB

FASB Accounting Standards Codification

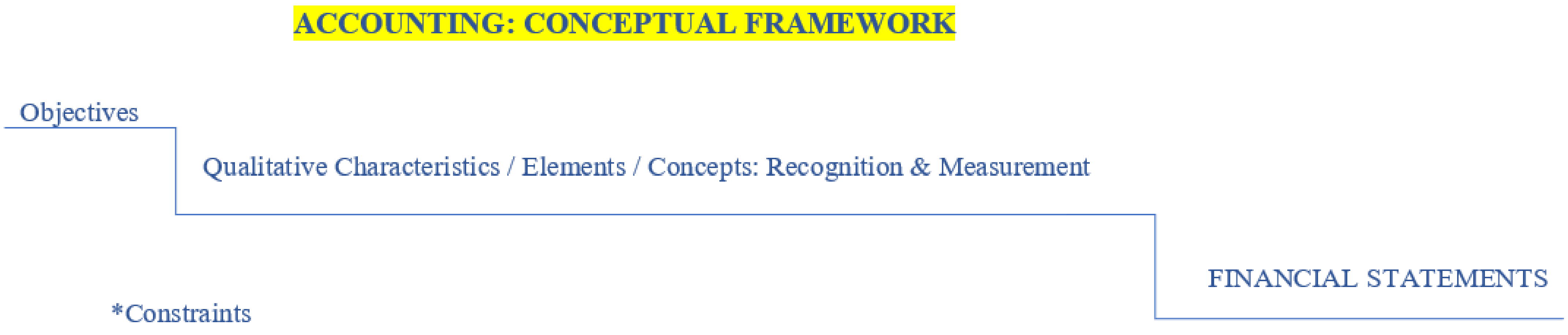
- Official Source of US GAAP / Includes 90 topics /Includes SEC guidance

Accounting Standards Update (ASU)

- New standard issued by FASB

ACCOUNTING: CONCEPTUAL FRAMEWORK

- Interrelated Fundamentals and Objectives for the uniforms application of the standards.
- Guidelines for measurement, summarize and disclosure the entity transactions.



ACCOUNTING: CONCEPTUAL FRAMEWORK

Objectives

Qualitative Characteristics / Elements / Concepts: Recognition & Measurement

FINANCIAL STATEMENTS

*Constraints

Provide useful information to investors / creditors for decision making.

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Fundamental characteristics

- **Relevance: help stakeholders to:**
  - (Predictive Value) Predict future cash flows, revenues, sales, etc.
  - Confirmatory Value) Confirms or modify prior decisions
- **Faithful representation: measurement and description according to real events**
  - Complete: includes all the information
  - Neutrality: unbiased
  - Free from errors: no errors or omissions when reporting the best information available

Enhancing characteristics

- **Comparability:** Helps stakeholders to identify similarities and differences.
- **Consistency:** Apply the same accounting practices to validate comparisons.
- **Verifiability:** different applied measures confirm that the information is accurate.
- **Timeliness:** the information is available at the precise moment for decision making.
- **Understandability:** stakeholders can understand the information based on the decision they are making.

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Elements

- Revenues: inflows from operations and increase equity
- Expenses: outflows or cost to generate revenues and decrease equity
- Gains: incidental activity (e.g. sale of non currents asset) and increase equity
- Losses: incidental activity (e.g. sale of non currents asset) and increase equity
- Assets: company recourses
- Liabilities: obligations
- Equity: residual interest
- Investments by owners: transfers of something of value to increase ownership participation (increase entity's capital)
- Distributions to owners: transfer distributions / dividends ((decrease entity's capital)
- Comprehensive income: change in equity balance due to transactions from nonowner sources (no related to investments or distributions to owners)

CORE PRINCIPLES

Recognition:

- Information is included in the financial statements, arising from the business transactions of the company.
- The elements of the financial statements are affected, and accounts are used to record them.

Measurement:

- which is the quantity by which the accounts arising from the transactions will be created.

Disclosure:

- select from the information to be disclosed in the financial statements and their notes.

Revenue recognition:

- records in the financial statements when:
- earned
- Realization: earning process is complete and reasonable certainty of the collection of cash.

Expense Recognition:

- incurred
- Often matches revenues and expenses that arise from the same transactions or other events.

Revenue recognition

1. Under both accrual-basis and cash-basis accounting, all revenues and expenses are eventually **recorded for the same amount**.

2. The **difference** between accrual-basis accounting and cash-basis accounting is in the **timing** of when we record those revenues and expenses.

CASH BASIS:

- Revenues is recorded when cash is received.
- Expenses is recorded when paid in cash

ACCRUAL BASIS

- Revenues is recorded when earned
- Expenses is recorded when incurred

ACCOUNTING

Assumptions

Economic entity:

- Only commercial transactions that correspond to the entity should be reported as part of its financial information.

Monetary unit:

- A monetary measure is used to measure the elements of the statements (e. g. US - $, Europe - €)

Periodicity:

- Divides the economic "artificial" life of a company into periods of time that allow disclosure (e. g. quarterly, annually)

Going concern:

- It assumes that an entity will continue to operate indefinitely. Justify the valuation of accounts (e. g. historical cost).

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Cost vs Benefit

- the cost of obtaining and disclosing the information is greater than the benefit it provides to users.

Materiality

If the inclusion or omission of any data affects decision-making (varies by company)