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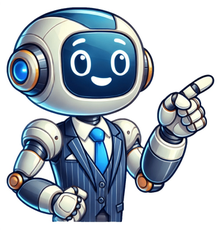

The generally accepted accounting principles (GAAP) are a set of accounting rules, standards, and procedures issued and frequently revised by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). These principles ensure consistency, accuracy, and transparency in financial reporting across various industries in the United States. Public companies must follow GAAP when preparing their financial statements, which is also widely used in governmental accounting. GAAP stands for generally accepted accounting principles, which set the standard accounting rules for preparing, presenting, and reporting financial statements in the U.S.The goal of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable.GAAP may be contrasted with pro forma accounting, a non-GAAP financial reporting method.GAAP is used mainly in the U.S., while most other countries follow the international financial reporting standards (IFRS).GAAP is also used by states and other government entities in the U.S. to prepare their financial statements. Theresa Chiechi / Investopedia GAAP combines authoritative standards set by policy boards and widely accepted methods for recording and reporting accounting information. It covers revenue recognition, balance sheet classification, and materiality. The main objective of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable, allowing investors to analyze and extract useful information from financial statements. It also facilitates the comparison of financial information across different companies. Unlike pro forma accounting, a non-GAAP method, GAAP provides a standardized framework. Internationally, the equivalent standard is the international financial reporting standards (IFRS), used in 168 jurisdictions worldwide. GAAP is also utilized by government entities. All 50 states follow GAAP, and many local entities, such as counties, cities, towns, and school districts, must adhere to these principles. If a corporation's stock is publicly traded, its financial statements must follow rules set by the U.S. Securities and Exchange Commission (SEC). The SEC mandates that publicly traded companies in the U.S. file GAAP-compliant financial statements regularly to maintain their public listing on stock exchanges. GAAP compliance is verified through an appropriate auditor's opinion, resulting from an external audit by a certified public accounting (CPA) firm. While non-publicly traded companies aren't required to follow GAAP, it is still highly regarded by lenders and creditors. Most financial institutions require annual GAAP-compliant financial statements as a part of their debt covenants when issuing business loans, leading many U.S. companies to adopt GAAP. Investors should be cautious if a financial statement isn't prepared using GAAP. Comparing financial statements across different companies—even within the same industry—becomes challenging without GAAP. Some companies may use GAAP and non-GAAP measures to report their financial results. GAAP regulations require that non-GAAP measures be identified in financial statements and other public disclosures, such as press releases. Even with GAAP's transparency rules, financial statements can still contain errors or misleading information. Always scrutinize financial statements, as there's potential for manipulation within GAAP's framework. The international financial reporting standards (IFRS), set by the International Accounting Standards Board (IASB), is an alternative to GAAP that is widely used worldwide. One key difference between GAAP and IFRS is the treatment of inventory. IFRS rules ban using last-in, first-out (LIFO) inventory accounting methods, whereas GAAP permits LIFO. Both systems accept the first-in, first-out (FIFO) and weighted average-cost methods. Since 2002, the IASB and the FASB have worked to align IFRS and GAAP. A significant milestone was reached in 2007 when the SEC allowed non-U.S. companies registered in the U.S. to use IFRS without reconciling to GAAP. This was a big achievement because it eliminated the need for non-U.S. companies on U.S. exchanges to provide GAAP-compliant financial statements. As global operations and markets expand, international standards like IFRS are gaining traction, even in the U.S. Nearly all S&P 500 companies report at least one non-GAAP measure in their financial statements. This trend is evident in the widespread use of several non-GAAP metrics, with 77% of S&P 500 companies reporting adjusted earnings, 77% using adjusted EPS (earnings per share), and 29% reporting EBITDA or adjusted EBITDA. Since much of the world uses the IFRS standard, a convergence to IFRS could benefit international corporations and investors alike. GAAP is used primarily in the United States, while the international financial reporting standards (IFRS) are in wider use internationally. GAAP is crucial for maintaining trust in the financial markets. Without GAAP, investors might be more reluctant to trust the information presented to them by public companies. Without that trust, fewer transactions and higher transaction costs could result, ultimately weakening the economy. GAAP also helps investors analyze companies by making it easier to perform "apples-to-apples" comparisons between one company and another, allowing for more accurate and consistent analysis. Companies can present certain figures without following GAAP guidelines, as long as they identify them as non-GAAP. Companies sometimes do that when they believe the GAAP rules don't fully capture specific operational nuances. In such cases, they may provide specially designed non-GAAP metrics alongside the required GAAP disclosures. However, investors should be cautious with non-GAAP measures, as they can sometimes be used to present a misleading view of a company's performance. GAAP is meant to ensure consistency, accuracy, and transparency in financial reporting and aims to provide a reliable foundation for investors to make informed decisions. While the rules established under GAAP generally improve the transparency in financial statements, they don't guarantee that a company's financial statements are free from errors or omissions meant to mislead investors. Always scrutinize financial statements, as there can still be room for manipulation within the framework of GAAP. Page 2 Systems of accounting, or accounting standards, are guidelines and regulations issued by governing bodies. They dictate how a company records its finances, how it presents its financial statements, and how it accounts for things such as inventories, depreciation, and amortization. How a company reports these figures will have a large impact on the figures that appear in financial statements and regulatory filings. Investors and financial analysts must be sure they understand which set of standards a company is using, and how its bottom line or financial ratios will change if the accounting system were different. To answer this question, it's important to differentiate between International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) to get a better grasp of the function they serve in the world of accounting. Accounting standards and guidelines for best practices differ by region and may be company-specific.IFRS is a global set of standards used by 15 of the G20 countries.GAAP is specific to the United States and has been adopted by the SEC. IFRS stands for International Financial Reporting Standards. The International Accounting Standards Board (IASB) is the accounting standards body for the IFRS Foundation. The predecessor to the IFRS Foundation, the International Accounting Standards Committee, was formed in 1973. Initial members were accounting bodies from Australia, Canada, France, Germany, Japan, Mexico, Netherlands, the U.K., and the United States. Today, IFRS has become the global standard for the preparation of public company financial statements and 144 out of 166 jurisdictions require IFRS standards. Fifteen of the G20 countries have adopted IFRS. China, India, and Indonesia have national accounting standards that are similar to IFRS, while Japan allows companies to follow the standards voluntarily. In the United States, foreign listed companies may use IFRS and are no longer required to reconcile their financial statements with GAAP. The IFRS Foundation works with more than a dozen consultative bodies, representing the many different stakeholder groups that are impacted by financial reporting. GAAP stands for generally accepted accounting principles and is the standard adopted by the Securities and Exchange Commission (SEC) in the U.S. Except for foreign companies, all companies that are publicly traded must adhere to the GAAP system of accounting. The best way to think of GAAP is as a set of rules that companies follow when their accountants report their financial statements. These rules help investors analyze and find the information they need to make sound financial decisions. IFRS is a principle of the standard-based approach and is used internationally, while GAAP is a rule-based system compiled in the U.S. The IASB does not set GAAP, nor does it have any legal authority over GAAP. The IASB can be thought of as a very influential group of people who are involved in debating and making up accounting rules. However, a lot of people actually do listen to what the IASB has to say on matters of accounting. When the IASB sets a brand new accounting standard, several countries tend to adopt the standard, or at least interpret it, and fit it into their individual country's accounting standards. These standards, as set by each particular country's accounting standards board, will in turn influence what becomes GAAP for each particular country. For example, in the United States, the Financial Accounting Standards Board (FASB) makes up the rules and regulations which become GAAP. Although the majority of the world uses IFRS standards, it is not part of the financial world in the U.S. The SEC continues to review switching to the IFRS but has yet to do so. Some major differences exist between the two sets of accounting standards. These include: Inventory: The first is with the LIFO Inventory. GAAP allows companies to use the Last in, First out (LIFO) as an inventory cost method. But LIFO is banned under IFRS. Development costs: Under GAAP, these costs are considered expenses. Under IFRS, the costs are capitalized and amortized over multiple periods. This applies to the internal costs of developing any intangible assets. Write-downs: GAAP specifies the write-down amount of an inventory or fixed asset can't be reversed if the market value of the asset subsequently increases. On the other hand, the IFRS allows the write-down to be reversed. This results in inventory values fluctuating more frequently under IFRS than under GAAP. Fixed Assets: Under GAAP, fixed assets such as property, plant, and equipment (PP&E), must be recorded at historical cost (the purchase price), and depreciated accordingly. Under IFRS, fixed assets are also valued at cost, but companies are allowed to revalue fixed assets to the fair market value. 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The information in these financial statements help lenders, investors and others evaluate a company or organization.While you may have hired an experienced professional to deal with the nitty-gritty of your business’s accounting, you owe it to yourself — and your employees, customers, and investors — to understand the basics of GAAP accounting.» MORE: NerdWallet's best small-business appsGenerally accepted accounting principles can be organized into three broad categories. Those categories are assumptions, principles, and constraints. Within each of these broader categories, there are a number of rules which dictate how GAAP-compliant accounting is supposed to be done.» MORE: NerdWallet's best accounting software for small businessesGet matched with a vetted expert who will handle it for you.via TaxGlobalGAAP rules are maintained by the Financial Accounting Standards Board (FASB) and in place to help protect business owners, consumers, and investors from fraud. They guarantee a measure of consistency in the accounting reports among all businesses. GAAP rules absolutely must be followed by publicly traded companies, but most small-business accountants adhere to them as well.How does this apply to you, the small-business owner? Well, understanding where your accountant is coming from will help you better communicate with them and allow you to verify your accounting is being done correctly. Even though your accountant is a trusted business advisor, you are ultimately responsible for your business’s financial information.Get matched with a vetted expert who will handle it for you.via TaxGlobalWe’re going to keep this as a high-level overview and spare you some of the drier details. You’re not training to be a CPA, after all. Think of this as a crash course in GAAP accounting. If you want more details, your accountant will be a valuable resource for you.One of the very first things your accountant probably told you when you started your business was to open a separate business bank account and keep your business and personal transactions separate. This wasn’t just because your accountant wanted to make their job easier.The generally accepted accounting principle behind this advice is the business entity assumption. Basically, this principle means that a business is an entity unto itself, and should be treated as such (which is also why this is sometimes called the “separate entity assumption”).Even in a sole proprietorship, where your business activity appears on your personal tax return, the business entity assumption still applies. This is because, legally, your business can exist independently of you.The monetary unit assumption states all business activity must be recorded in the same currency. This is why you have to go through the extra effort to complete your bookkeeping for foreign transactions.Another assumption under this generally accepted accounting principle is that the purchasing power of currency remains static over time. In other words, inflation is not considered in the financial reports of a business, even if that business has existed for decades.Dates are important, and this is especially true when dealing with GAAP accounting.A balance sheet always reports information as of a certain date. Profit and loss statements, also called income statements, encompass a date range. All financial statements have to indicate the time period for the activity reported in order for them to be meaningful to those reviewing them. This is the specific time period assumption.Always check your financial statements for dates, and make sure the information reported on your financial statements makes sense for the dates encompassed by the report. A balance sheet will indicate the report is “as of” or “at” a certain date. Profit and loss statements will indicate they are for a specific date range.The going concern assumption is also referred to as the “non-death principle.” This principle assumes the business will continue to exist and function indefinitely.The going concern assumption is what allows a business to defer the recognition of expenses to a later accounting period. If an accountant is concerned the business might be forced to close and liquidate, they are required to disclose this concern under GAAP.The historical cost principle in GAAP accounting says that the cost of an item doesn’t change in the financial reporting. So, even if you’ve bought something that has skyrocketed in value since you purchased it — like a building in a part of town undergoing regentrification — your accountant will still report the asset at the amount for which it was obtained, regardless of fair market value.The historical cost principle also highlights an important concept: It’s critical not to confuse cost with value. The value of things will change over time, and this is reflected in the gain or loss on sale of assets as well as in depreciation entries. Cost, however, will always remain the same on your financials.If you need a true valuation of your business without selling off your assets, you’ll need to bring in an expert in business valuations rather than relying on your financial statements.Whenever a generally accepted accounting principle makes it into the news, it is almost without fail the full disclosure principle. Or, more specifically, it’s because of failure to follow the full disclosure principle.Under the full disclosure principle, a business is required to disclose all information that relates to the function of its financial statements in notes accompanying the statements. This principle helps ensure stockholders and investors are not misled by any aspect of the financial reports.In other words, it’s always important to read the fine print, even — or maybe especially — in your financial statements.Most small businesses are on a cash basis for tax purposes, meaning revenue is reported when cash is received and expenses are reported when cash is spent (or your business’s credit card is charged). But certain businesses are required to report all financial information on an accrual basis, largely due to the matching principle.Under the matching principle, sales and the expenses used to produce those sales are reported in the same accounting period. These expenses can include wages, sales commissions, certain overhead costs, etc.Even if your tax return is on a cash basis, your accountant may prepare your financial reports on an accrual basis. Accrual basis reports reflect the matching principle and provide a better analysis of your business’ performance and profitability than cash basis statements.The revenue recognition principle — like the matching principle — is an accrual basis accounting principle. In a nutshell, under the accrual basis of accounting, revenue is reported when it’s earned, regardless of when payment for the product or service is actually received. This is the revenue recognition principle. Similar to the matching principle, the revenue recognition principle accurately reports income, or revenue, when the sale was made, even if you bill your customer or receive payment at a later time.The materiality principle is one of two generally accepted accounting principles that allows the accountant to use their best judgment when recording a transaction or addressing an error.You most often see the materiality principle at play when an accountant is reconciling a set of books or completing a tax return. If the account is off by a relatively small amount in relation to the overall size of the business, the accountant might deem the discrepancy as immaterial. If a discrepancy is immaterial, it can be disregarded. Material discrepancies, on the other hand, must be addressed.Similarly, immaterial expenses can be recognized at the time of purchase, but material expenses must be depreciated over time.It’s important here for the accountant to be empowered to use their professional opinion. Since businesses come in all sizes, an amount that might be significant, or material for one business may be insignificant, or immaterial for another.The principle of conservatism is the other GAAP principle that allows the accountant to use their best judgment in a situation. When there’s more than one acceptable way to record a transaction, the principle of conservatism instructs the accountant to choose the option that yields the most conservative results for the business they’re working with.There is an important rule to remember here: This principle is only invoked when either way the accountant can record the transaction is acceptable. It does not allow the accountant to completely disregard other accounting principles.The objectivity principle is one of the most important constraints under generally accepted accounting principles. According to the objectivity principle, GAAP-compliant financial statements provided by your accountant must be based on objective evidence.You can think of this as the “just the facts, ma’am” principle. The objectivity principle is, in part, the reason many companies will have an independently audited set of financial statements produced on a routine basis.Accounting can be an art as much as a science. Depending on the accounting methods used, the same data presented in different ways can have a dramatic impact on your business’s financial statements.The consistency principle seeks to increase clarity around a business’s financial statements and to prevent switching the methods used in order to get more favorable-looking results. According to this constraint, the accountant must use the same accounting methods and follow the same accounting principles for each accounting period. This will ensure you are comparing apples to apples when you review your financial statements for multiple accounting periods.The final constraint under generally accepted accounting principles is the cost constraint principle. This is also one of the trickier principles, because it can be hard to quantify.According to the cost constraint principle, the cost of reporting financial information should be less than the benefit derived from that financial information. In other words, providing financial information in accordance with GAAP should not cause an undue financial burden.However, this doesn’t mean a business is exempt from complying with GAAP simply because of the cost involved. This principle typically applies to a small number of companies and only if the financial information being provided is truly inconsequential in relation to the cost.NerdWallet rating NerdWallet's ratings are determined by our editorial team. The scoring formula incorporates coverage options, customer experience, customizability, cost and more.QuickBooks Online $30 per month and up. Read Review.NerdWallet rating NerdWallet's ratings are determined by our editorial team. The scoring formula incorporates coverage options, customer experience, customizability, cost and more.FreshBooks Accounting $19 per month and up. Read Review.NerdWallet rating NerdWallet's ratings are determined by our editorial team. The scoring formula incorporates coverage options, customer experience, customizability, cost and more.Xero $15 per month and up.NerdWallet rating NerdWallet's ratings are determined by our editorial team. 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These principles were determined by the Financial Accounting Standards Board (FASB). Principle of Regularity Principle of Consistency Principle of Sincerity Principle of Permanence of Methods Principle of Non-Compensation Principle of Prudence Principle of Continuity Principle of Periodicity Principle of Materiality Principle of Utmost Good Faith GAAP ensures the key topics of revenue recognition, balance sheet classification and materiality are easy to understand across all documents from all companies. GAAP includes both strict rules and best practices, thereby providing both specific requirements and flexible guidance for atypical situations. These regulations ensure that investors can easily understand the financial health of each company, and easily compare companies before making investment decisions. U.S. law requires all publicly traded companies, or companies releasing financial statements to the public, to follow GAAP principles. More From Built In’s Tech DictionaryWhat Is Financial Accounting? Introduction to GAAP (Generally Accepted Accounting Principles). | Video: Edspira What Are the Generally Accepted Accounting Principles (GAAP)? GAAP consists of 10 fundamental principles that inform the rules around financial reporting. For atypical situations when companies need to use more flexible reporting methods, they are expected to follow these guidelines: Principle of Regularity: The accountant must adhere to all GAAP rules and regulations. Principle of Consistency: Accountants presenting financial information commit to using the same methods and regulations both within one, and across several, time periods. If the accountant changes methods between time periods, they will leave a clear declaration of how and why they used a different approach. Principle of Sincerity: Accountants must provide an accurate and impartial view of a company’s financial health. Principle of Permanence of Methods: All principles used in financial accounting are to be consistent, which enables comparison across both companies and time periods. Principle of Non-Compensation: Accountants will report both negative and positive aspects of a company’s financial health with full transparency. The accountant shall not expect additional compensation for presenting a company’s financial health in a positive light. Principle of Prudence: All presented information is to be fact-based and shall not include speculation. Principle of Continuity: All estimates of asset values are to assume that the company continues to operate. This principle is especially important for companies that are at risk of shutting down in the near future. Principle of Periodicity: Revenue and expense entries are to be tracked in the appropriate time period. Both revenues and expenses are tracked in the time period in which they occurred. Principle of Materiality: Accountants are to present all appropriate data and accounting information in the reports. Principle of Utmost Good Faith: Accountants are required to always act in good faith and present information honestly when preparing and reviewing company financial documents. Why Is GAAP Compliance Important? GAAP helps maintain trust in financial markets by ensuring that public companies’ financial information is accurate and easy to understand. When companies use GAAP, investors can trust that the information they receive is accurate, allowing for clear and easy comparisons between multiple companies. The ease of comparison enables investors to make decisions based on an accurate understanding of organizations’ financial health. GAAP vs. IFRS: What’s the Difference? GAAP is a U.S.-based set of rules and regulations. The International Accounting Standards Board creates a similar set of guidelines and principles, the International Financial Reporting Standards (IFRS), which is used in a similar way internationally. While GAAP is a rules-based set of regulations, IFRS is a less strict set of principles companies are encouraged to follow. There are several differences between the two, including: GAAP allows companies to use last in, first out (LIFO) inventory cost tracking, which is prohibited in IFRS. GAAP requires that research and development costs are charged as an expense during the period in which they occurred, while IFRS allows amortizing the expenses over multiple periods if certain conditions are met. GAAP requires that value write-downs are permanent, and cannot be reversed if the value of an item later increases, while IFRS allows reversal of write-downs. GAAP is short for generally accepted accounting principles. It refers to a series of rules and best practices for performing consistent and accurate financial reporting. All publicly traded U.S. companies must follow GAAP. Many government agencies and private businesses also choose to follow GAAP, although it’s not required for any entities other than public companies. GAAP ensures transparent financial reporting by prioritizing consistency and accuracy among reports. This gives investors a clear overview of each company’s financial health, allowing them to make more informed investing decisions. The core of GAAP revolves around a list of ten principles. Together, these principles are meant to clearly define, standardize and regulate the reporting of a company’s financial information and to prevent tampering of data or unethical practices. 1. Principle of Regularity GAAP must always be followed by accountants and businesses when handling financial information. At no point can a company or financial team choose to ignore or modify any of the regulations. 2. Principle of Consistency Accountants are responsible for using the same standards and practices for all accounting periods. If a method or practice is changed, or if you hire a new accountant with a different system, the change must be fully documented and justified in the footnotes of the financial statements. This principle ensures that any company’s internal financial documentation is consistent over time. 3. Principle of Sincerity This principle states that any accountant or accounting team hired by a company is obligated to provide the most unbiased, accurate financial report possible. Although a business may be in a bad financial situation, one that may even compromise its future, the accountant may only report on the situation as it is. 4. Principle of Permanence of Methods This principle requires accountants to use the same reporting method procedures across all the financial statements prepared. Though it is similar to the second principle, it narrows in specifically on financial reports—ensuring any report prepared by one company can be easily compared to one another. 5. Principle of Non-Compensation All negative and positive values on a financial statement, regardless of how they reflect upon the company, must be clearly reported by the accounting team. Accountants cannot try to make things look better by compensating a debt with an asset or an expense with revenue. 6. Principle of Prudence Formally reported data must be fact-based and dependent on clear, concrete numbers. It’s easy to start wandering into speculation when you talk about finance—especially when thinking about the future of the company—and this principle makes sure to keep accountants firmly grounded in reality. Businesses can still engage in speculation and forecasting, of course, but they cannot add this information to formal financial statements. 7. Principle of Continuity When compiling reports, accountants must assume a business will continue to operate. The principle applies regardless of the status of the company. 8. Principle of Periodicity Essentially, this principle requires accountants to report financial information only in the relevant accounting period. For example, if an accounting team is compiling a report on the revenue earned within a quarter, the report must focus only on that exact period. This is intended to prevent any possibility of fudging numbers or data across time—e.g., if a company earns more one quarter than the next, the accountant must truthfully represent this fact instead of changing the period dates or altering the data to hide or reduce the difference. 9. Principle of Materiality Accountants must, to the best of their abilities, fully and clearly disclose all the available financial data of the company. They are obligated to acquire this information from the business, which is why an accounting team’s requests may seem intensely thorough when requesting financial information. 10. Principle of Utmost Good Faith Any person or party involved in, or responsible for, the financial side of a business must be honest in all reports and transactions. Along with several other principles, this serves to maintain an ethical standard and responsibility in all financial dealings. Understanding Generally Accepted Accounting Principles (GAAP) is essential for businesses and investors. These principles provide the foundation for consistent financial reporting in the United States, ensuring transparency and comparability across organizations’ financial statements. Key Principles of GAAP GAAP is built on core principles guiding the preparation and presentation of financial statements. The principle of consistency requires companies to use the same accounting methods over time, enabling stakeholders to compare financial statements accurately. For instance, switching from the straight-line method to the declining balance method for depreciation without proper disclosure could mislead investors about a company’s financial health. The principle of relevance ensures financial information is useful for decision-making, emphasizing timely and pertinent data. For example, disclosure of contingent liabilities or subsequent events, such as a pending lawsuit with potential financial implications, provides a complete picture of risks. Reliability, or objectivity, mandates that financial information be verifiable and free from significant error or bias. This principle relies on objective evidence like invoices or contracts to support transactions, ensuring financial statements offer an accurate view of a company’s performance and position, which is vital for investor confidence. GAAP vs. IFRS GAAP is rules-based, providing detailed guidelines for financial reporting, while IFRS follows a principles-based approach, offering broader guidelines that require interpretation and judgment. This distinction allows IFRS more flexibility to reflect a company’s unique circumstances. Inventory treatment highlights a key difference between the two. GAAP permits the Last-In, First-Out (LIFO) method, which can help manage tax liabilities by matching recent costs with revenues. IFRS prohibits LIFO, prioritizing consistency across international boundaries and focusing on presenting economic realities. Revenue recognition further underscores these differences. GAAP uses detailed criteria to determine when revenue is recognized, focusing on the transfer of risks and rewards. IFRS emphasizes the transfer of control, offering more discretion in assessing when revenue is earned. For instance, a software company might recognize revenue earlier under IFRS by assessing when the customer gains control, whereas GAAP might require a different timeline based on performance obligations. Misconceptions About GAAP A common misconception is that GAAP is a static set of rules. In reality, it evolves to address new financial challenges and practices. The Financial Accounting Standards Board (FASB), which oversees GAAP, regularly issues updates to ensure relevance. For example, the Accounting Standards Codification (ASC) streamlined GAAP’s complexity, making it more accessible. Another misunderstanding is that GAAP applies uniformly to all organizations. Its application varies depending on industry and entity size. For instance, revenue recognition standards differ for retail companies and construction firms, reflecting their operational differences. Private companies may also follow simplified reporting guidelines under the Private Company Council (PCC). Some believe compliance with GAAP guarantees absolute financial accuracy. While GAAP aims to present an accurate view of an organization’s financial position, it cannot eliminate judgment or estimation in reporting. Areas like asset impairment or warranty liabilities require significant judgment, which can lead to variations in outcomes. Transparency and disclosure are critical for users to understand the assumptions and methods applied. Role of GAAP in Financial Analysis GAAP serves as a standardized framework for financial analysis, enabling analysts and investors to compare financial statements across companies and industries. This uniformity allows for efficient evaluation of performance using metrics like the current ratio, return on equity, and debt-to-equity ratio. For example, analysts can confidently compare a firm’s liquidity with peers, knowing the reports adhere to the same principles. Detailed GAAP disclosures enhance financial analysis by providing insights into accounting policies, risks, and contingent liabilities. For instance, a company facing significant environmental liabilities must disclose these obligations, allowing analysts to assess their long-term financial impact. Enjoy sharper detail, more accurate color, lifelike lighting, believable backgrounds, and more with our new model update. Your generated images will be more polished than ever.See What's NewExplore how consumers want to see climate stories told today, and what that means for your visuals.Download Our Latest VisualGPS ReportData-backed trends. Generative AI demos. Answers to your usage rights questions. 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Our original video podcast covers it all—now on demand.Watch Now The generally accepted accounting principles (GAAP) are a set of accounting rules, standards, and procedures issued and frequently revised by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). These principles ensure consistency, accuracy, and transparency in financial reporting across various industries in the United States. Public companies must follow GAAP when preparing their financial statements, which is also widely used in governmental accounting. GAAP stands for generally accepted accounting principles, which set the standard accounting rules for preparing, presenting, and reporting financial statements in the U.S.The goal of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable.GAAP may be contrasted with pro forma accounting, a non-GAAP financial reporting method.GAAP is used mainly in the U.S., while most other countries follow the international financial reporting standards (IFRS).GAAP is also used by states and other government entities in the U.S. to prepare their financial statements. Theresa Chiechi / Investopedia GAAP combines authoritative standards set by policy boards and widely accepted methods for recording and reporting accounting information. It covers revenue recognition, balance sheet classification, and materiality. The main objective of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable, allowing investors to analyze and extract useful information from financial statements. It also facilitates the comparison of financial information across different companies. Unlike pro forma accounting, a non-GAAP method, GAAP provides a standardized framework. Internationally, the equivalent standard is the international financial reporting standards (IFRS), used in 168 jurisdictions worldwide. GAAP is also utilized by government entities. All 50 states follow GAAP, and many local entities, such as counties, cities, towns, and school districts, must adhere to these principles. If a corporation's stock is publicly traded, its financial statements must follow rules set by the U.S. Securities and Exchange Commission (SEC). The SEC mandates that publicly traded companies in the U.S. file GAAP-compliant financial statements regularly to maintain their public listing on stock exchanges. GAAP compliance is verified through an appropriate auditor's opinion, resulting from an external audit by a certified public accounting (CPA) firm. While non-publicly traded companies aren't required to follow GAAP, it is still highly regarded by lenders and creditors. Most financial institutions require annual GAAP-compliant financial statements as a part of their debt covenants when issuing business loans, leading many U.S. companies to adopt GAAP. Investors should be cautious if a financial statement isn't prepared using GAAP. Comparing financial statements across different companies—even within the same industry—becomes challenging without GAAP. Some companies may use GAAP and non-GAAP measures to report their financial results. GAAP regulations require that non-GAAP measures be identified in financial statements and other public disclosures, such as press releases. Even with GAAP's transparency rules, financial statements can still contain errors or misleading information. Always scrutinize financial statements, as there's potential for manipulation within GAAP's framework. The international financial reporting standards (IFRS), set by the International Accounting Standards Board (IASB), is an alternative to GAAP that is widely used worldwide. One key difference between GAAP and IFRS is the treatment of inventory. IFRS rules ban using last-in, first-out (LIFO) inventory accounting methods, whereas GAAP permits LIFO. Both systems accept the first-in, first-out (FIFO) and weighted average-cost methods. Since 2002, the IASB and the FASB have worked to align IFRS and GAAP. A significant milestone was reached in 2007 when the SEC allowed non-U.S. companies registered in the U.S. to use IFRS without reconciling to GAAP. This was a big achievement because it eliminated the need for non-U.S. companies on U.S. exchanges to provide GAAP-compliant financial statements. As global operations and markets expand, international standards like IFRS are gaining traction, even in the U.S. Nearly all S&P 500 companies report at least one non-GAAP measure in their financial statements. This trend is evident in the widespread use of several non-GAAP metrics, with 77% of S&P 500 companies reporting adjusted earnings, 77% using adjusted EPS (earnings per share), and 29% reporting EBITDA or adjusted EBITDA. Since much of the world uses the IFRS standard, a convergence to IFRS could benefit international corporations and investors alike. GAAP is used primarily in the United States, while the international financial reporting standards (IFRS) are in wider use internationally. GAAP is crucial for maintaining trust in the financial markets. Without GAAP, investors might be more reluctant to trust the information presented to them by public companies. Without that trust, fewer transactions and higher transaction costs could result, ultimately weakening the economy. GAAP also helps investors analyze companies by making it easier to perform "apples-to-apples" comparisons between one company and another, allowing for more accurate and consistent analysis. Companies can present certain figures without following GAAP guidelines, as long as they identify them as non-GAAP. Companies sometimes do that when they believe the GAAP rules don't fully capture specific operational nuances. In such cases, they may provide specially designed non-GAAP metrics alongside the required GAAP disclosures. However, investors should be cautious with non-GAAP measures, as they can sometimes be used to present a misleading view of a company's performance. GAAP is meant to ensure consistency, accuracy, and transparency in financial reporting and aims to provide a reliable foundation for investors to make informed decisions. While the rules established under GAAP generally improve the transparency in financial statements, they don't guarantee that a company's financial statements are free from errors or omissions meant to mislead investors. Always scrutinize financial statements, as there can still be room for manipulation within the framework of GAAP. Page 2 Systems of accounting, or accounting standards, are guidelines and regulations issued by governing bodies. They dictate how a company records its finances, how it presents its financial statements, and how it accounts for things such as inventories, depreciation, and amortization. How a company reports these figures will have a large impact on the figures that appear in financial statements and regulatory filings. Investors and financial analysts must be sure they understand which set of standards a company is using, and how its bottom line or financial ratios will change if the accounting system were different. To answer this question, it's important to differentiate between International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) to get a better grasp of the function they serve in the world of accounting. Accounting standards and guidelines for best practices differ by region and may be company-specific.IFRS is a global set of standards used by 15 of the G20 countries.GAAP is specific to the United States and has been adopted by the SEC. IFRS stands for International Financial Reporting Standards. The International Accounting Standards Board (IASB) is the accounting standards body for the IFRS Foundation. The predecessor to the IFRS Foundation, the International Accounting Standards Committee, was formed in 1973. Initial members were accounting bodies from Australia, Canada, France, Germany, Japan, Mexico, Netherlands, the U.K., and the United States. Today, IFRS has become the global standard for the preparation of public company financial statements and 144 out of 166 jurisdictions require IFRS standards. Fifteen of the G20 countries have adopted IFRS. China, India, and Indonesia have national accounting standards that are similar to IFRS, while Japan allows companies to follow the standards voluntarily. In the United States, foreign listed companies may use IFRS and are no longer required to reconcile their financial statements with GAAP. The IFRS Foundation works with more than a dozen consultative bodies, representing the many different stakeholder groups that are impacted by financial reporting. GAAP stands for generally accepted accounting principles and is the standard adopted by the Securities and Exchange Commission (SEC) in the U.S. Except for foreign companies, all companies that are publicly traded must adhere to the GAAP system of accounting. The best way to think of GAAP is as a set of rules that companies follow when their accountants report their financial statements. These rules help investors analyze and find the information they need to make sound financial decisions. IFRS is a principle of the standard-based approach and is used internationally, while GAAP is a rule-based system compiled in the U.S. The IASB does not set GAAP, nor does it have any legal authority over GAAP. The IASB can be thought of as a very influential group of people who are involved in debating and making up accounting rules. However, a lot of people actually do listen to what the IASB has to say on matters of accounting. When the IASB sets a brand new accounting standard, several countries tend to adopt the standard, or at least interpret it, and fit it into their individual country's accounting standards. These standards, as set by each particular country's accounting standards board, will in turn influence what becomes GAAP for each particular country. For example, in the United States, the Financial Accounting Standards Board (FASB) makes up the rules and regulations which become GAAP. Although the majority of the world uses IFRS standards, it is not part of the financial world in the U.S. The SEC continues to review switching to the IFRS but has yet to do so. Some major differences exist between the two sets of accounting standards. These include: Inventory: The first is with the LIFO Inventory. GAAP allows companies to use the Last in, First out (LIFO) as an inventory cost method. But LIFO is banned under IFRS. Development costs: Under GAAP, these costs are considered expenses. Under IFRS, the costs are capitalized and amortized over multiple periods. This applies to the internal costs of developing any intangible assets. Write-downs: GAAP specifies the write-down amount of an inventory or fixed asset can't be reversed if the market value of the asset subsequently increases. On the other hand, the IFRS allows the write-down to be reversed. This results in inventory values fluctuating more frequently under IFRS than under GAAP. Fixed Assets: Under GAAP, fixed assets such as property, plant, and equipment (PP&E), must be recorded at historical cost (the purchase price), and depreciated accordingly. Under IFRS, fixed assets are also valued at cost, but companies are allowed to revalue fixed assets to the fair market value. 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Deepen your knowledge of GAAP and its practical applications.In the United States, companies that make public financial disclosures must use a standardized system of accounting methods and practices. These methods and practices are collectively known as generally accepted accounting principles (GAAP), which facilitate:Consistency across all financial disclosuresAccurate analysis of an organization's financial standingDirect comparisons between competing businessesIn addition to publicly traded companies, GAAP is widely used in governmental accounting. Many businesses also voluntarily adopt GAAP for their internal financial tracking.Many bachelor's programs in accounting cover GAAP in their curricula. To better understand these important accounting principles, learn more about how they work in this guide.Learn More About Our PartnersGAAP-compliant accounting practices draw on many different principles, which students often encounter in their coursework and training. Notable guidelines separate an organization's transactions from the personal transactions of its owners, standardize currency units used in reports, and explicitly disclose the time periods covered by specific reports. They also draw on established best practices governing cost, disclosure, matching, revenue recognition, professional judgment, and conservatism.Examples of essential GAAP principles include:Principle of Regularity: GAAP-compliant accountants strictly adhere to established rules and regulations.Principle of Consistency: Consistent standards are applied throughout the financial reporting process.Principle of Conservatism: This principle guides accountants to use high levels of caution and diligence when verifying data and preparing entries and documents, especially in cases involving uncertainty.Principle of Matching: When reporting revenues, accountants should match those revenues with their associated costs by simultaneously reporting any expenses the organization incurred in generating them.Principle of Non-Compensation: All aspects of an organization's performance, whether positive or negative, are fully reported with no prospect of debt compensation.Principle of Prudence: Speculation does not influence the reporting of financial data.Principle of Continuity: Asset valuations assume the organization's operations will continue.Principle of Periodicity: Reporting of revenues is divided by standard accounting periods, such as fiscal quarters or fiscal years.Principle of Materiality: Financial reports fully disclose the organization's monetary situation.Principle of Utmost Good Faith: All involved parties are assumed to be acting honestly.Without regulatory standards, companies would be free to present financial information in whichever format best suits their needs. With the ability to portray a company's fiscal standing in a favorable light, investors could be easily misled.The Great Depression in 1929, a financial catastrophe that caused years of hardship for millions of Americans, was primarily attributed to faulty and manipulative reporting practices among businesses. In response, the federal government, along with professional accounting groups, set out to create standards for the ethical and accurate reporting of financial information.All 50 state governments prepare their financial reports according to GAAP. The Governmental Accounting Standards Board (GASB) estimates that about half of the states officially require local and county governments to adhere to GAAP.Government institutions, including federal legislative and judicial branches, enforce compliance with GAAP guidelines. However, the government itself plays no role in developing or updating the associated accounting practices. Instead, that is left to private organizations and independent boards.The following subsections introduce and explain the roles that various boards and organizations play in the ongoing development of generally accepted accounting principles.Founded in 1972, the Financial Accounting Foundation (FAF) oversees and governs both the Financial Accounting Standards Board (FASB) and the Government Accounting Standards Board (GASB). The FASB and GASB both operate within the FAF, working alongside the FAF's management group and board of trustees to enhance the quality of public and governmental accounting standards.The FASB was founded in 1973 to serve as the independent body for developing and improving financial reporting standards for publicly traded companies, private businesses, and nonprofit organizations. A seven-member board, appointed to five-year terms by FAF trustees, leads the FASB. The FAF retains responsibility for funding, administering, and overseeing the FASB.Recent Major ProjectsThe FASB regularly reviews accounting standards and conducts ongoing initiatives to improve them. Some notable recent FASB projects include:Changes to Income Tax Disclosures: Enacted in response to investor feedback, this December 2023 change updated income tax disclosure requirements to provide more transparency surrounding tax reconciliations and payment dates.Cryptocurrency Accounting and Disclosure Requirements: Finalized in December 2023, these important changes created a standardized system for tracking an organization's cryptocurrency assets. It also introduced cryptocurrency-specific accounting and disclosure requirements.Measurement Conceptual Framework Update: Adopted in July 2024, this update clarified preferred methods for selecting measurement systems for assets and liabilities tracked in general financial statements.Induced Conversions of Convertible Debt Instruments: In this complex and technical November 2024 update, the FASB refined its standards for tracking induced conversions of convertible debt instruments to improve reporting consistency.The GASB became part of the FAF in 1984, functioning as the body responsible for managing GAAP accounting standards for state and local governments. Like the FASB, the GASB is led by a seven-member, FAF-appointed governing board. Most board members may serve for up to two five-year terms, while the GASB's chairperson holds office for one seven-year term.Recent Major ProjectsLike the FASB, the GASB also regularly reviews and updates its accounting standards and guidance. Recent GASB initiatives include:Risks and Uncertainties Disclosures Updates: In December 2023, the GASB adopted new requirements surrounding state and local government disclosures of known and potential financial risks and uncertainties.Financial Reporting Model Updates: Approved in April 2024, these updates implemented changes to several reporting models used by the GASB. The new policies apply to various budget and financial statements issued by publicly funded colleges, state governments, and local governments.Changes to the Classification of Non-Financial Assets: In September 2024, the GASB reexamined the way it treats certain types of non-financial, capital, and intangible assets. The approved changes clarified best practices for classifying and reporting such assets.Fair Value Post-Implementation Review: In February 2015, the GASB adopted new rules surrounding the measurement and application of an accounting principle known as fair value. It then conducted a comprehensive review of those rules, which was presented to GABS trustees in February 2025.Some organizations use non-GAAP, or “pro forma” accounting methods. Businesses that are legally required to use GAAP in their public financial disclosures for compliance reasons sometimes use pro forma methods in their other financial statements. Similarly, organizations that are not bound by GAAP compliance requirements may also prefer pro forma accounting.Pro forma accounting offers one important advantage: Businesses can use it to create customized financial projections and forecasts without GAAP restrictions. As Harvard Business School notes, pro forma accounting excels at generating insights into hypothetical “what-if” scenarios while GAAP does not.However, pro forma accounting may contain unspecified estimates and assumptions. Pro forma financial statements are also unaudited and may include little contextual information, and they often lack the inherent comparability facilitated by GAAP. For these reasons, pro forma financial statements can be misleading, inconsistent, and less transparent despite appearances to the contrary.GAAP is designed to prevent reporting inconsistencies and errors, but the system still has some limitations. For example, compliant organizations require significant internal accounting expertise, which is expensive. Additional limitations and issues apply to:As noted in this 2019 Journal of Accountancy article, smaller private businesses often lack the financial resources required to comply with the technical complexities of GAAP reporting. This may impact their ability to attract financing and investment, potentially creating competitive disadvantages that favor larger, wealthier companies. The FASB and GASB can take a long time to complete reviews and issue updates to their reporting standards. For example, the GASB took 10 years to complete a post-implementation review of its changes to the fair value reporting principle in 2015. This can create inconsistencies and inaccuracies as compliant organizations await guidance.GAAP standards are widely used in the United States. However, most other countries use different accounting protocols, with the International Financial Reporting Standards (IFRS) system being the most common.These differing systems can create challenges for U.S. organizations dealing with businesses operating in other countries, and for companies operating both inside and outside the United States.The International Accounting Standards Board (IASB) develops, publishes, and oversees the accounting principles enshrined in IFRS practices. According to IASB data from March 2025, 147 global jurisdictions mandate the use of the IFRS system for most or all public financial disclosures that impact their financial markets.Because U.S. companies use GAAP rather than IFRS, complexities and inconsistencies can occur in international business settings. Publicly traded domestic U.S. companies must use GAAP, but U.S. businesses with a significant international presence may also issue financial statements prepared according to IFRS guidelines.Since 2002, the FASB and IASB have collaborated on strategies for minimizing inconsistencies arising from competing accounting systems. As of March 2025, the most recent impactful collaborative development occurred in 2013, when the FASB joined a 12-member advisory board working toward converging the GAAP and IFRS systems.Other than the fact that IFRS is adopted globally and GAAP is used U.S., the major difference between them relates to rules vs. principles. Despite the word “principles” in its name, the GAAP system is rules-based and has largely inflexible requirements. Meanwhile, IFRS standards are principles-based, offering more flexibility when interpreting guidelines.While both systems intend to protect the integrity and accuracy of financial disclosures, they also diverge in significant ways. The following table offers a high-level summary of some of the major differences between them:GAAP vs. IFRSKey DifferenceGAAPIFRSConceptual FrameworkNon-authoritative and not typically referenced by accountants when preparing financial statements Conceptual Framework guidance is authoritativeBasic Preparation of Financial StatementsSpecific disclosures are required if an entity faces the imminent need to liquidateNo specific disclosure standards apply about potentially imminent liquidationForms and Components of Financial StatementsComparative data is encouraged but not requiredBusinesses with multiple subsidiaries must issue consolidated financial statements Comparative data is required when it applies to material disclosuresExemptions are available to some businesses with multiple subsidiaries that wish to consolidate their financial statementsStatement of Financial PositionSEC registrants must conform to regulations regarding the format and presentation of a minimum number of line itemsCertain line items are required to be presented, but there is no prescribed formatGAAP is a set of accounting rules that publicly traded companies must use when preparing balance sheets, income statements, and other financial documents. The rules establish clear reporting standards that make it easier to evaluate a company's financial standing.Students may find GAAP difficult to learn at first. GAAP includes many complex principles that require deep, technical accounting knowledge. However, you can master GAAP with diligence, persistence, and hard work.U.S. based publicly traded companies with domestic operations must use GAAP in their financial disclosures. Tax-exempt nonprofit groups, organizations that receive taxpayer-funded resources from the U.S. federal government, and businesses in certain regulated industries are also required to use GAAP. Organizations subject to GAAP requirements must prepare their balance sheets, income statements, cash flow statements, and statements of shareholders' equity using GAAP principles. Notably, IFRS guidelines have the same financial statement requirements as GAAP.Brush up on basic accounting terms and learn about essential terminology and key concepts.The accounting field doesn't stand still. Stay informed on industry developments with accounting resources and links to the industry's leading voices.Thinking about pursuing a career as an accountant? Review our list of the top accounting skills you'll need to succeed. Share — copy and redistribute the material in any medium or format for any purpose, even commercially. Adapt — remix, transform, and build upon the material for any purpose, even commercially. The licensor cannot revoke these freedoms as long as you follow the license terms. Attribution — You must give appropriate credit , provide a link to the license, and indicate if changes were made . You may do so in any reasonable manner, but not in any way that suggests the licensor endorses you or your use. ShareAlike — If you remix, transform, or build upon the material, you must distribute your contributions under the same license as the original. No additional restrictions — You may not apply legal terms or technological measures that legally restrict others from doing anything the license permits. You do not have to comply with the license for elements of the material in the public domain or where your use is permitted by an applicable exception or limitation . No warranties are given. The license may not give you all of the permissions necessary for your intended use. For example, other rights such as publicity, privacy, or moral rights may limit how you use the material. Learn the basics to jump-start your accounting career with these helpful guides on accounting fundamentals. See All PostsMay 21, 2025Deep knowledge of GAAP can boost your accounting career. Learn about generally accepted accounting principles with this information resource...August 30, 2024Tax preparation certifications signal elite levels of professional competence. Learn how to qualify for and earn yours with this career resource...May 21, 2025Online accounting certificate programs can help you quickly train for new careers or build on your existing credentials. Research options with this guide...May 21, 2025Bookkeeping certification can make you more employable while boosting your earning potential. Explore two popular certification pathways in this career guide... A commonly recognized set of rules and procedures governing corporate accounting and financial reporting Over 2 million + professionals use CFI to learn accounting, financial analysis, modeling and more. Unlock the essentials of corporate finance with our free resources and get an exclusive sneak peek at the first module of each course. Start Free GAAP, or Generally Accepted Accounting Principles, is a commonly recognized set of rules and procedures designed to govern corporate accounting and financial reporting in the United States (US). The US GAAP is a comprehensive set of accounting practices that were developed jointly by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB), so they are applied to governmental and non-profit accounting as well. US securities law requires all publicly-traded companies, as well as any company that publicly releases financial statements, to follow the GAAP principles and procedures. In addition, or as an alternative, are the International Financial Reporting Standards (IFRS) established by the International Accounting Standards Board (IASB). The IFRS rules govern accounting standards in the European Union, as well as in a number of countries in South America and Asia. The Core GAAP Principles GAAP is set forth in 10 primary principles, as follows: Principle of consistency: This principle ensures that consistent standards are followed in financial reporting from period to period. Principle of permanent methods: Closely related to the previous principle is that of consistent procedures and practices being applied in accounting and financial reporting to allow comparison. Principle of non-compensation: This principle states that all aspects of an organization's performance, whether positive or negative, are to be reported. In other words, it should not compensate (offset) a debt with an asset. Principle of prudence: All reporting of financial data is to be factual, reasonable, and not speculative. Principle of regularity: This principle means that all accountants are to consistently abide by the GAAP. Principle of sincerity: Accountants should perform and report with basic honesty and accuracy. Principle of good faith: Similar to the previous principle, this principle asserts that anyone involved in financial reporting is expected to be acting honestly and in good faith. Principle of materiality: All financial reporting should clearly disclose the organization's genuine financial position. Principle of continuity: This principle states that all asset valuations in financial reporting are based on the assumption that the business or other entity will continue to operate going forward. Principle of periodicity: This principle refers to entities abiding by commonly accepted financial reporting periods, such as quarterly or annually. The Generally Accepted Accounting Principles further set out specific rules and principles governing such things as standardized currency units, cost and revenue recognition, financial statement format and presentation, and required disclosures. For example, it requires precise matching of expenses with revenues for the same accounting period (the matching principle). History of GAAP Generally Accepted Accounting Principles were eventually established primarily as a response to the Stock Market Crash of 1929 and the subsequent Great Depression, which were believed to be at least partially caused by less than forthright financial reporting practices by some publicly-traded companies. The federal government began working with professional accounting groups to establish standards and practices for consistent and accurate financial reporting. Generally Accepted Accounting Principles began to be established with legislation such as the Securities Act of 1933 and the Securities Exchange Act of 1934. The GAAP has gradually evolved, based on established concepts and standards, as well as on best practices that have come to be commonly accepted across different industries. Why is GAAP Important? Generally Accepted Accounting Principles make financial reporting standardized and transparent, using commonly accepted terms, practices, and procedures. The consistency of presentation of financial reports that results from GAAP makes it easy for investors and other interested parties (such as a board of directors) to more easily comprehend financial statements and compare the financial statements of one company with those of another company. GAAP also seeks to make non-profit and governmental entities more accountable by requiring them to clearly and honestly report their finances. In short, GAAP is designed to ensure a consistent presentation of financial statements, making it easier for people to read and comprehend the information contained in the statements. Applications in Financial Analysis For financial analysts performing valuation work and financial modeling, it's important to have a solid understanding of accounting principles. While this is important, financial models focus more on cash flow and economic value, which is not significantly impacted by accounting principles (other than for the calculation of cash taxes). Alternatives to GAAP GAAP is the set of standards and practices that are followed in the United States, but what about other countries? Outside the US, the alternative in most countries is the International Financial Reporting Standards (IFRS), which is regulated by the International Accounting Standards Board (IASB). While the two systems have different principles, rules, and guidelines, IFRS and GAAP have been working towards merging the two systems. Additional Resources Thank you for reading CFI's guide to GAAP. To further your education, the following CFI resources will also be helpful: 10 PrinciplesFAFFASBGASBNon-GAAPIFRSFAQGenerally accepted accounting principles play a major role in U.S. financial reporting practices. Deepen your knowledge of GAAP and its practical applications.In the United States, companies that make public financial disclosures must use a standardized system of accounting methods and practices. These methods and practices are collectively known as generally accepted accounting principles (GAAP), which facilitate:Consistency across all financial disclosuresAccurate analysis of an organization's financial standingDirect comparisons between competing businessesIn addition to publicly traded companies, GAAP is widely used in governmental accounting. Many businesses also voluntarily adopt GAAP for their internal financial tracking.Many bachelor's programs in accounting cover GAAP in their curricula. To better understand these important accounting principles, learn more about how they work in this guide.Learn More About Our PartnersGAAP-compliant accounting practices draw on many different principles, which students often encounter in their coursework and training. Notable guidelines separate an organization's transactions from the personal transactions of its owners, standardize currency units used in reports, and explicitly disclose the time periods covered by specific reports. They also draw on established best practices governing cost, disclosure, matching, revenue recognition, professional judgment, and conservatism.Examples of essential GAAP principles include:Principle of Regularity: GAAP-compliant accountants strictly adhere to established rules and regulations.Principle of Consistency: Consistent standards are applied throughout the financial reporting process.Principle of Conservatism: This principle guides accountants to use high levels of caution and diligence when verifying data and preparing entries and documents, especially in cases involving uncertainty.Principle of Matching: When reporting revenues, accountants should match those revenues with their associated costs by simultaneously reporting any expenses the organization incurred in generating them.Principle of Non-Compensation: All aspects of an organization's performance, whether positive or negative, are fully reported with no prospect of debt compensation.Principle of Prudence: Speculation does not influence the reporting of financial data.Principle of Continuity: Asset valuations assume the organization's operations will continue.Principle of Periodicity: Reporting of revenues is divided by standard accounting periods, such as fiscal quarters or fiscal years.Principle of Materiality: Financial reports fully disclose the organization's monetary situation.Principle of Utmost Good Faith: All involved parties are assumed to be acting honestly.Without regulatory standards, companies would be free to present financial information in whichever format best suits their needs. With the ability to portray a company's fiscal standing in a favorable light, investors could be easily misled.The Great Depression in 1929, a financial catastrophe that caused years of hardship for millions of Americans, was primarily attributed to faulty and manipulative reporting practices among businesses. In response, the federal government, along with professional accounting groups, set out to create standards for the ethical and accurate reporting of financial information.All 50 state governments prepare their financial reports according to GAAP. The Governmental Accounting Standards Board (GASB) estimates that about half of the states officially require local and county governments to adhere to GAAP.Government institutions, including federal legislative and judicial branches, enforce compliance with GAAP guidelines. However, the government itself plays no role in developing or updating the associated accounting practices. Instead, that is left to private organizations and independent boards.The following subsections introduce and explain the roles that various boards and organizations play in the ongoing development of generally accepted accounting principles.Founded in 1972, the Financial Accounting Foundation (FAF) oversees and governs both the Financial Accounting Standards Board (FASB) and the Government Accounting Standards Board (GASB). The FASB and GASB both operate within the FAF, working alongside the FAF's management group and board of trustees to enhance the quality of public and governmental accounting standards.The FASB was founded in 1973 to serve as the independent body for developing and improving financial reporting standards for publicly traded companies, private businesses, and nonprofit organizations. A seven-member board, appointed to five-year terms by FAF trustees, leads the FASB. The FAF retains responsibility for funding, administering, and overseeing the FASB.Recent Major ProjectsThe FASB regularly reviews accounting standards and conducts ongoing initiatives to improve them. Some notable recent FASB projects include:Changes to Income Tax Disclosures: Enacted in response to investor feedback, this December 2023 change updated income tax disclosure requirements to provide more transparency surrounding tax reconciliations and payment dates.Cryptocurrency Accounting and Disclosure Requirements: Finalized in December 2023, these important changes created a standardized system for tracking an organization's cryptocurrency assets. It also introduced cryptocurrency-specific accounting and disclosure requirements.Measurement Conceptual Framework Update: Adopted in July 2024, this update clarified preferred methods for selecting measurement systems for assets and liabilities tracked in general financial statements.Induced Conversions of Convertible Debt Instruments: In this complex and technical November 2024 update, the FASB refined its standards for tracking induced conversions of convertible debt instruments to improve reporting consistency.The GASB became part of the FAF in 1984, functioning as the body responsible for managing GAAP accounting standards for state and local governments. Like the FASB, the GASB is led by a seven-member, FAF-appointed governing board. Most board members may serve for up to two five-year terms, while the GASB's chairperson holds office for one seven-year term.Recent Major ProjectsLike the FASB, the GASB also regularly reviews and updates its accounting standards and guidance. Recent GASB initiatives include:Risks and Uncertainties Disclosures Updates: In December 2023, the GASB adopted new requirements surrounding state and local government disclosures of known and potential financial risks and uncertainties.Financial Reporting Model Updates: Approved in April 2024, these updates implemented changes to several reporting models used by the GASB. The new policies apply to various budget and financial statements issued by publicly funded colleges, state governments, and local governments.Changes to the Classification of Non-Financial Assets: In September 2024, the GASB reexamined the way it treats certain types of non-financial, capital, and intangible assets. The approved changes clarified best practices for classifying and reporting such assets.Fair Value Post-Implementation Review: In February 2015, the GASB adopted new rules surrounding the measurement and application of an accounting principle known as fair value. 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Despite the word “principles” in its name, the GAAP system is rules-based and has largely inflexible requirements. Meanwhile, IFRS standards are principles-based, offering more flexibility when interpreting guidelines.While both systems intend to protect the integrity and accuracy of financial disclosures, they also diverge in significant ways. 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The rules establish clear reporting standards that make it easier to evaluate a company's financial standing.Students may find GAAP difficult to learn at first. GAAP includes many complex principles that require deep, technical accounting knowledge. However, you can master GAAP with diligence, persistence, and hard work.U.S. based publicly traded companies with domestic operations must use GAAP in their financial disclosures. Tax-exempt nonprofit groups, organizations that receive taxpayer-funded resources from the U.S. federal government, and businesses in certain regulated industries are also required to use GAAP. Organizations subject to GAAP requirements must prepare their balance sheets, income statements, cash flow statements, and statements of shareholders' equity using GAAP principles. Notably, IFRS guidelines have the same financial statement requirements as GAAP.Brush up on basic accounting terms and learn about essential terminology and key concepts.The accounting field doesn't stand still. Stay informed on industry developments with accounting resources and links to the industry's leading voices.Thinking about pursuing a career as an accountant? Review our list of the top accounting skills you'll need to succeed. If you run a small business, you may not know much about the Generally Accepted Accounting Principles (GAAP). After all, GAAP standards apply mainly to publicly traded companies, so these rules don't always feel relevant to your small business.However, it's a good idea to have a basic understanding of GAAP standards. Knowing the fundamentals will help you improve your accounting skills, understand accounting principles, and determine how your business should track and measure its financial information.Editor's note: Looking for the right accounting software for your business? Fill out the below questionnaire to have our vendor partners contact you about your needs.GAAP refers to the rules and standards used for financial reporting in the United States. These standards were developed by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB); they apply to corporate, government and nonprofit accounting.The U.S. Securities and Exchange Commission (SEC) requires all publicly traded companies to adhere to GAAP standards. When each company reports and maintains its financial records the same way, it's easier for investors to compare companies and make informed investment decisions.GAAP requires publicly traded companies to follow four main standards:Recognition: Financial statements should accurately reflect your company's assets, liabilities, revenue and expenses.Measurement: Financial statements should measure your organization's financial results in accordance with GAAP standards.Presentation: For each reporting period, your business will present an income statement, balance sheet, cash flow statement and statement of shareholder equity.Disclosure: All financial statements will include any notes necessary to help users interpret the information.Even if you employ an accountant or bookkeeper, understanding GAAP standards helps business owners ensure accurate and transparent financial reporting.These 10 principles will help you understand the purpose of GAAP:Regularity: Your accountant has followed all GAAP rules and regulations.Consistency: Accountants commit to applying the same standards from one period to the next. This consistency makes it easier to avoid errors and ensure financial comparability. If an accountant makes a change, they must disclose it in the financial statement footnotes.Sincerity: Your accountant will provide an impartial and accurate view of your company's financial situation.Permanence of methods: There should always be a focus on consistency in the methods used during the accounting cycle.Noncompensation: Your accountant will report all financial information transparently, outlining the positives and negatives. This report is made without the expectation of debt compensation.Prudence: All financial data must be reported based on actual figures, not speculation.Continuity: This principle assumes your business will continue operating into the foreseeable future.Periodicity: All accounting entries are reported during the appropriate periods. For example, both revenue and expenses will be reported during the correct periods.Materiality: Accountants must disclose all relevant financial information accurately in reports.Utmost good faith: This principle emphasizes honesty and full disclosure among all parties during financial transactions.To hire the right accountant for your business, seek out someone with appropriate experience who can explain accounting concepts clearly.If you run a publicly traded company, the SEC requires your business to follow GAAP standards. You must complete GAAP-compliant financial statements to remain listed on the stock exchanges.GAAP compliance is not required for private companies, but many lenders prefer it. If you plan to apply for a business loan, you may be required to file GAAP-compliant financial statements.Additionally, investors are often wary of businesses that don't follow GAAP standards. That's because the consistency of GAAP standards makes it easier to compare financial statements. If you ever plan to take your company public, it's smart to begin adopting GAAP standards now.“GAAP compliance is important because it ensures consistency, audit readiness and regulatory compliance,” said Armine Alajian, founder and CPA at Alajian Group, Inc. “It ensures consistency, matching revenues with expenses, so true profit is reported.”The best accounting software solutions are designed in accordance with GAAP principles and can help simplify your financial accounting. Many accounting platforms are affordable, easy to use and integrate seamlessly with your other business software.GAAP standards are based on principles like accrual accounting, revenue recognition and expense matching. However, Alajian cautioned that GAAP does come with certain limitations.“There can be limitations with cash flow reports,” Alajian explained. “It can be difficult to see how a business is doing from an accrual or cash flow [standpoint], and it can also be costly and time-consuming.”For that reason, some companies supplement their financial reports with non-GAAP statements, often referred to as pro forma statements. The goal is to present a more accurate and complete view of the company's underlying operations.Non-GAAP statements can include the following:Free cash flowEarnings before interest and taxes (EBIT)Earnings before interest, taxes, depreciation and amortization (EBITDA)Adjusted earningsFunds from operationsProponents of non-GAAP reporting believe that including this information presents a more nuanced view of the company to investors. Critics argue that using non-GAAP financial statements could result in misleading or fraudulent reporting. In particular, the SEC has issued a statement advising caution when it comes to pro forma statements.Most companies operate on either a cash or accrual accounting basis. Cash-basis accounting records revenue when the business receives payment. In contrast, accrual accounting records revenue when a customer receives the goods or services — whether or not the company has been paid.GAAP standardizes the financial reporting process and creates a common accounting language that all U.S.-based businesses can follow. It ensures that all companies adhere to the same reporting procedures, making it easier for investors to understand and compare financial statements. GAAP also requires companies to report their financial data fairly and accurately. Maintaining GAAP standards builds trust in the financial markets and makes it easier for investors to feel confident investing in companies.GAAP is required for all publicly traded companies in the U.S. However, many private companies also choose to follow these standards. GAAP standards apply to corporate, nonprofit and government accounting practices alike.The FASB and the GASB created GAAP standards in response to the 1929 stock market crash and the Great Depression. At the time, many publicly traded companies were not always accurate in reporting their financial data, which likely contributed to the stock market crash. GAAP was later formally established through the Securities Act of 1933 and the Securities Exchange Act of 1934.If you aren't a publicly traded company, following GAAP standards may not be necessary. However, all businesses should be familiar with these five basic accounting principles: Revenue recognition principle: This principle states that any revenue should be recorded once your buyer receives the good or service your company provides — not after your business is compensated. This is what's known as accrual accounting. Cost principle: Your accountant should record an expense when your company accepts goods or services from another business — whether or not payment has been made. Matching principle: All expenses should match the revenue received during a given accounting period. If your company recognizes revenue, it should also acknowledge the associated costs. Full disclosure principle: Financial statements should include accurate and complete information so stakeholders have all relevant information about your company. Objectivity principle: All accounting data should be fact-based and free of assumptions. All financial data should be supported by receipts, invoices and vouchers. International Financial Reporting Standards (IFRS) is a set of accounting principles designed for publicly traded companies. Issued by the International Accounting Standards Board (IASB), IFRS has been adopted by 120 countries, including all members of the European Union. These standards are intended to increase consistency and transparency in financial reporting for companies around the world. Like GAAP, IFRS outlines how companies should maintain their financial records and report income and expenses. It creates a global accounting language that investors, auditors and government regulators can understand. Public companies in the U.S. must follow GAAP standards. While the SEC has expressed interest in switching to IFRS, there has been no real movement.Here's a breakdown of the primary differences between IFRS and GAAP: IFRS GAAP Issued by the IASB Issued by the FASB Doesn't allow the last-in, first-out (LIFO) method to estimate inventory Allows use of either the last-in, first-out (LIFO) or first-in, first-out (FIFO) method to estimate inventory Intangible assets are assessed based on future economic benefit Intangible assets are measured based on their fair market value Allows companies more flexibility in interpreting financial statements Follows a specific set of rules and procedures for financial statements Revenue can be reported once value is delivered Revenue can be reported once goods or services are delivered Groups all liabilities together Groups liabilities as either current or noncurrent Here is additional information about the primary differences between GAAP and IFRS: Inventory reporting: One of the most significant differences between GAAP and IFRS is how the two standards treat inventory reporting. With IFRS, you can't use the LIFO method to measure inventory. IFRS standards maintain that LIFO doesn't portray inventory flow accurately and could make your company's income appear lower than it is. In comparison, GAAP standards allow your company to track its inventory using either LIFO or FIFO. Intangible assets: GAAP and IFRS approach intangible assets differently. Under IFRS, intangible assets can be recognized if they offer a probable future economic benefit to your firm. However, GAAP recognizes intangible assets based on their current fair market value — without assessing future benefits. Financial reporting: GAAP standards follow a highly specific set of rules and procedures with little room for interpretation. These rules are designed to prevent accountants from inflating your business's financial records to mislead investors. However, IFRS would give your company more room for interpretation in your financial reporting. Revenue recognition: GAAP has specific standards for recognizing revenue across different industries. Generally, revenue cannot be reported until the buyer has received the goods or services purchased from your organization. IFRS states that revenue can be recognized once the value has been delivered to your clients, even if payment hasn't yet been received. Liabilities classification: Under GAAP standards, liabilities are classified as either current or noncurrent based on how long your business has to repay its debts. Debt due within the next 12 months is considered a current liability, while debt with a repayment period longer than 12 months is considered long-term debt. IFRS, by contrast, groups all liabilities together without this distinction. The generally accepted accounting principles (GAAP) are a set of accounting rules, standards, and procedures issued and frequently revised by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). These principles ensure consistency, accuracy, and transparency in financial reporting across various industries in the United States. Public companies must follow GAAP when preparing their financial statements, which is also widely used in governmental accounting. GAAP stands for generally accepted accounting principles, which set the standard accounting rules for preparing, presenting, and reporting financial statements in the U.S.The goal of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable.GAAP may be contrasted with pro forma accounting, a non-GAAP financial reporting method.GAAP is used mainly in the U.S., while most other countries follow the international financial reporting standards (IFRS).GAAP is also used by states and other government entities in the U.S. to prepare their financial statements. Theresa Chiechi / Investopedia GAAP combines authoritative standards set by policy boards and widely accepted methods for recording and reporting accounting information. It covers revenue recognition, balance sheet classification, and materiality. The main objective of GAAP is to ensure that a company's financial statements are complete, consistent, and comparable, allowing investors to analyze and extract useful information from financial statements. It also facilitates the comparison of financial information across different companies. Unlike pro forma accounting, a non-GAAP method, GAAP provides a standardized framework. Internationally, the equivalent standard is the international financial reporting standards (IFRS), used in 168 jurisdictions worldwide. GAAP is also utilized by government entities. All 50 states follow GAAP, and many local entities, such as counties, cities, towns, and school districts, must adhere to these principles. If a corporation's stock is publicly traded, its financial statements must follow rules set by the U.S. Securities and Exchange Commission (SEC). The SEC mandates that publicly traded companies in the U.S. file GAAP-compliant financial statements regularly to maintain their public listing on stock exchanges. GAAP compliance is verified through an appropriate auditor's opinion, resulting from an external audit by a certified public accounting (CPA) firm. While non-publicly traded companies aren't required to follow GAAP, it is still highly regarded by lenders and creditors. Most financial institutions require annual GAAP-compliant financial statements as a part of their debt covenants when issuing business loans, leading many U.S. companies to adopt GAAP. Investors should be cautious if a financial statement isn't prepared using GAAP. Comparing financial statements across different companies—even within the same industry—becomes challenging without GAAP. Some companies may use GAAP and non-GAAP measures to report their financial results. GAAP regulations require that non-GAAP measures be identified in financial statements and other public disclosures, such as press releases. Even with GAAP's transparency rules, financial statements can still contain errors or misleading information. Always scrutinize financial statements, as there's potential for manipulation within GAAP's framework. The international financial reporting standards (IFRS), set by the International Accounting Standards Board (IASB), is an alternative to GAAP that is widely used worldwide. One key difference between GAAP and IFRS is the treatment of inventory. IFRS rules ban using last-in, first-out (LIFO) inventory accounting methods, whereas GAAP permits LIFO. Both systems accept the first-in, first-out (FIFO) and weighted average-cost methods. Since 2002, the IASB and the FASB have worked to align IFRS and GAAP. A significant milestone was reached in 2007 when the SEC allowed non-U.S. companies registered in the U.S. to use IFRS without reconciling to GAAP. This was a big achievement because it eliminated the need for non-U.S. companies on U.S. exchanges to provide GAAP-compliant financial statements. As global operations and markets expand, international standards like IFRS are gaining traction, even in the U.S. Nearly all S&P 500 companies report at least one non-GAAP measure in their financial statements. This trend is evident in the widespread use of several non-GAAP metrics, with 77% of S&P 500 companies reporting adjusted earnings, 77% using adjusted EPS (earnings per share), and 29% reporting EBITDA or adjusted EBITDA. Since much of the world uses the IFRS standard, a convergence to IFRS could benefit international corporations and investors alike. GAAP is used primarily in the United States, while the international financial reporting standards (IFRS) are in wider use internationally. GAAP is crucial for maintaining trust in the financial markets. Without GAAP, investors might be more reluctant to trust the information presented to them by public companies. Without that trust, fewer transactions and higher transaction costs could result, ultimately weakening the economy. GAAP also helps investors analyze companies by making it easier to perform "apples-to-apples" comparisons between one company and another, allowing for more accurate and consistent analysis. Companies can present certain figures without following GAAP guidelines, as long as they identify them as non-GAAP. Companies sometimes do that when they believe the GAAP rules don't fully capture specific operational nuances. In such cases, they may provide specially designed non-GAAP metrics alongside the required GAAP disclosures. However, investors should be cautious with non-GAAP measures, as they can sometimes be used to present a misleading view of a company's performance. GAAP is meant to ensure consistency, accuracy, and transparency in financial reporting and aims to provide a reliable foundation for investors to make informed decisions. While the rules established under GAAP generally improve the transparency in financial statements, they don't guarantee that a company's financial statements are free from errors or omissions meant to mislead investors. Always scrutinize financial statements, as there can still be room for manipulation within the framework of GAAP. Page 2 Systems of accounting, or accounting standards, are guidelines and regulations issued by governing bodies. They dictate how a company records its finances, how it presents its financial statements, and how it accounts for things such as inventories, depreciation, and amortization. How a company reports these figures will have a large impact on the figures that appear in financial statements and regulatory filings. Investors and financial analysts must be sure they understand which set of standards a company is using, and how its bottom line or financial ratios will change if the accounting system were different. To answer this question, it's important to differentiate between International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) to get a better grasp of the function they serve in the world of accounting. Accounting standards and guidelines for best practices differ by region and may be company-specific.IFRS is a global set of standards used by 15 of the G20 countries.GAAP is specific to the United States and has been adopted by the SEC. IFRS stands for International Financial Reporting Standards. The International Accounting Standards Board (IASB) is the accounting standards body for the IFRS Foundation. The predecessor to the IFRS Foundation, the International Accounting Standards Committee, was formed in 1973. Initial members were accounting bodies from Australia, Canada, France, Germany, Japan, Mexico, Netherlands, the U.K., and the United States. Today, IFRS has become the global standard for the preparation of public company financial statements and 144 out of 166 jurisdictions require IFRS standards. Fifteen of the G20 countries have adopted IFRS. China, India, and Indonesia have national accounting standards that are similar to IFRS, while Japan allows companies to follow the standards voluntarily. In the United States, foreign listed companies may use IFRS and are no longer required to reconcile their financial statements with GAAP. The IFRS Foundation works with more than a dozen consultative bodies, representing the many different stakeholder groups that are impacted by financial reporting. GAAP stands for generally accepted accounting principles and is the standard adopted by the Securities and Exchange Commission (SEC) in the U.S. Except for foreign companies, all companies that are publicly traded must adhere to the GAAP system of accounting. The best way to think of GAAP is as a set of rules that companies follow when their accountants report their financial statements. These rules help investors analyze and find the information they need to make sound financial decisions. IFRS is a principle of the standard-based approach and is used internationally, while GAAP is a rule-based system compiled in the U.S. The IASB does not set GAAP, nor does it have any legal authority over GAAP. The IASB can be thought of as a very influential group of people who are involved in debating and making up accounting rules. However, a lot of people actually do listen to what the IASB has to say on matters of accounting. When the IASB sets a brand new accounting standard, several countries tend to adopt the standard, or at least interpret it, and fit it into their individual country's accounting standards. These standards, as set by each particular country's accounting standards board, will in turn influence what becomes GAAP for each particular country. For example, in the United States, the Financial Accounting Standards Board (FASB) makes up the rules and regulations which become GAAP. Although the majority of the world uses IFRS standards, it is not part of the financial world in the U.S. The SEC continues to review switching to the IFRS but has yet to do so. Some major differences exist between the two sets of accounting standards. These include: Inventory: The first is with the LIFO Inventory. GAAP allows companies to use the Last in, First out (LIFO) as an inventory cost method. But LIFO is banned under IFRS. Development costs: Under GAAP, these costs are considered expenses. Under IFRS, the costs are capitalized and amortized over multiple periods. This applies to the internal costs of developing any intangible assets. Write-downs: GAAP specifies the write-down amount of an inventory or fixed asset can't be reversed if the market value of the asset subsequently increases. On the other hand, the IFRS allows the write-down to be reversed. This results in inventory values fluctuating more frequently under IFRS than under GAAP. Fixed Assets: Under GAAP, fixed assets such as property, plant, and equipment (PP&E), must be recorded at historical cost (the purchase price), and depreciated accordingly. Under IFRS, fixed assets are also valued at cost, but companies are allowed to revalue fixed assets to the fair market value.

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