

About GAAP

While many businesses assume that accountants are bound by generally accepted accounting practices and that these are inviolate, nothing could be further from the truth. Everything is subject to interpretation, and GAAP is no different. For one thing, GAAP themselves permit alternative accounting methods to be used for certain expenses and for revenue in certain specialized types of businesses. For another, GAAP methods require that decisions be made about the timing for recording revenue and expenses, or they require that key factors be quantified. Deciding on the timing of revenue and expenses and putting definite values on these factors require judgments, estimates and interpretations.

The mission of GAAP over the years has been to standardize accounting methods in order to bring about uniformity across all businesses. But alternative methods are still permitted for certain basic business expenses. No tests are required to determine whether one method is more preferable than another. A business is free to select whichever method it wants. But it must choose which cost of good sold expense method to use and which depreciation expense method to use.

For other expenses and for sales revenue, one general accounting method has been established; there are no alternative methods. However, a business has a fair amount of latitude in actually implementing the methods. One business applies the accounting methods in a conservative manner, and another business applies the methods in a more liberal manner. The end result is more diversity between businesses in their profit measure and financial statements than one might expect, considering that GAAP have been evolving since 1930.

The pronouncement on GAAP prepared by the Financial Accounting Standards Board (FASB) is now more than 1000 pages long. And that doesn't even include the rules and regulations issued by the federal regulatory agency that jurisdiction over the financial reporting and accounting methods of publicly owned businesses - the Securities and Exchange Commission (SEC).