

Is There A Gap In GAAP?

Keeping Up with the Changes
(or maybe not)

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Issues with GAAP for Nonpublic Entities

- Standards overload
- Inapplicable standards
- Extent and content of disclosures
- Does not necessarily reflect economic substance of transactions

Financial Reporting Frameworks

- Set of criteria for recognition, measurement, reporting, & disclosure of material financial statement elements
- Should be fair presentation framework
- May be general purpose financial reporting framework or special purpose financial reporting framework

Fair Presentation Frameworks

- Establish requirements that are to be complied with;
- Acknowledges potential need for disclosures in excess of those required; and
- Acknowledges possibility that departure may be required, but only rarely, to achieve fair presentation

General Purpose Financial Reporting Frameworks

- All considered GAAP
 - GAAP from FASB
 - IFRS from IASB
 - IFRS for SMEs from IASB

Special Purpose Financial Reporting Frameworks

- Also referred to as OCCBOA (Other Comprehensive Bases of Accounting):
 - Cash basis
 - Tax basis
 - Regulatory basis
 - Contractual basis
 - FRF for SMEs
 - Other bases

FRF for SMEs – An AICPA Creation

- Self-contained financial reporting framework
- Incorporates traditional accounting principles and accrual income tax methods
 - Historical cost is primary measurement basis
 - Accounting alternatives available to meet needs of end users
 - 172 pages in its entirety (188 with glossary)

Attributes of FRF for SMEs

- Objectivity – Free of bias
- Measurability – Consistent measurements
- Completeness – Includes all factors relevant to drawing conclusions
- Relevance – Provides information valuable to users

Characteristics of Entities to Benefit from Adoption

- No regulatory requirements necessitating GAAP
- No intention of going public
- For-profit
- Often owner-managed
- Financial statements used by owners and managers
 - Assessment of performance and cash flows
 - Knowledge of what is owned and what is owed

Additional Characteristics of Potential Adopters

- Not operating in an industry with transactions requiring specialized accounting guidance
- No overly complex transactions or significant foreign operations
- Primary users have access to management

Users of Financial Statements Prepared Under FRF for SMEs

- Largely interested in cash flows, liquidity, strength of financial position, and coverage of interest
- Lenders rely on available collateral and other factors in addition to financial statements

Focus on Small or Medium-sized For-Profit Private Entities

- Addresses transactions traditionally entered into
- Provides general principles, concepts, and criteria
 - Applied to transactions not specifically addressed
 - Requires management judgment

Concepts Underlying FRF for SMEs

- Financial statements
- Materiality
- Qualitative characteristics
- Reliability
- Comparability

Financial Statements

- Normally include statements related to financial position, operations, changes in equity, and cash flows
- Notes and supporting schedules are integral part
- Reflects past activity but may require estimates
- Material items not netted unless specifically allowed

Availability of Financial Statements for Issuance

- Financial statements, including required disclosures have been prepared;
- All appropriate journal entries reflected in financial statements;
- No changes planned or expected; and
- Approved for issuance based on entity's processes

Objectives of Financial Statements

- Communication of information useful to:
 - Management
 - Creditors
 - Other users
- Provide information regarding:
 - Resources, obligations, and equity
 - Changes in resources, obligations, and equity
 - Economic performance

Materiality and Qualitative Characteristics

- Information material if it is probable that misstatement or omission would effect decisions
- Matter of professional judgment
- Immaterial information not presented or disclosed separately

Qualitative Characteristics

- Understandability to users:
 - Reasonable understanding of business, economics, and accounting
 - Willing to study information
- Relevance to user decisions
 - Assist in evaluation of effects of past, present, or future events and transactions; or confirm or correct previous evaluations.
 - Predictive or feedback value on timely basis

Additional Qualitative Characteristics

- Reliable in reporting of actual transactions and events, can be verified, and is free of error or bias
 - Representational faithfulness
 - Verifiability
 - Neutrality
- Conservatism in developing estimates
 - Avoid overstatement of assets, revenues, and gains
 - Avoid understatement of liabilities, expenses, and losses

Comparability

- Involves application of the same accounting policies from period to period
- Prevents misconceptions from use of different policies in different periods
- Requires disclosure of effects of changes in accounting policies

Elements of Financial Reporting

– Financial Position

- Assets – Economic resources providing future benefit accessible to entity resulting from past transaction or event
- Liabilities – Economic obligations requiring nondiscretionary future transfer of resources or benefits at a specific time, occurrence of an event, or on demand resulting from a past transaction or event
- Equity – Ownership interest in assets after deduction liabilities

Elements of Financial Reporting

– Results of Operations

- Revenues – Inflow of economic resources or reductions in liabilities arising from sales of goods or services, or compensation for use of resources by others
- Expenses – Decreases in economic resources resulting from revenue generating activities
- Gains and losses – Increases (gains) or decreases (losses) in equity from peripheral or incidental transactions and events

Bases of Measurement

- Replacement cost
- Realizable value
- Present value
- Market value

Features of FRF for SMEs

- Excluded GAAP principles:
 - Impairment testing
 - Comprehensive income
 - Industry guidance
 - Variable interest entities (VIEs)
 - Evaluation of uncertain tax positions
- Simplified accounting for leases

Additional features of FRF for SMEs

- Options
 - Consolidation or equity method for controlled entities
 - Income taxes payable or deferred income tax method
- Limited use of fair value
- Amortization of goodwill and all identifiable intangibles
- Capitalization of some internally generated intangibles

Fair Value

- Traditional definition – Sales price agreed upon by a willing buyer and a willing seller when both enter the transaction freely and knowledgeably
- Current definition – The amount at which an asset could be bought or sold, or a liability could be incurred or settled in a current transaction between willing parties; or
- The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Changes to Traditional Topics

- Inventories – Lower of cost or net realizable value
- Investments in equity securities not subject to consolidation or equity method at market value with unrealized gains and losses recognized in income