

Generally Accepted Accounting Practices (GAAP)

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Generally accepted accounting principles, or GAAP, are standards that encompass the details, complexities, and legalities of business and corporate accounting. The Financial Accounting Standards Board (FASB) uses GAAP as the foundation for its comprehensive set of approved accounting methods and practices.

U.S. law requires businesses releasing financial statements to the public and companies publicly traded on stock exchanges and indices to follow GAAP guidelines. GAAP incorporates the following 10 concepts:

1. **Principle of Regularity:** GAAP-compliant accountants strictly adhere to established rules and regulations.
2. **Principle of Consistency:** Consistent standards are applied throughout the financial reporting process.
3. **Principle of Sincerity:** GAAP-compliant accountants are committed to accuracy and impartiality.
4. **Principle of Permanence of Methods:** Consistent procedures are used in the preparation of all financial reports.
5. **Principle of Non-Compensation:** All aspects of an organization's performance, whether positive or negative, are fully reported with no prospect of debt compensation.
6. **Principle of Prudence:** Speculation does not influence the reporting of financial data.
7. **Principle of Continuity:** Asset valuations assume the organization's operations will continue.
8. **Principle of Periodicity:** Reporting of revenues is divided by standard accounting periods, such as fiscal quarters or fiscal years.
9. **Principle of Materiality:** Financial reports fully disclose the organization's monetary situation.
10. **Principle of Utmost Good Faith:** All involved parties are assumed to be acting honestly.

GAAP compliance makes the financial reporting process transparent and standardizes assumptions, terminology, definitions, and methods. External parties can easily compare financial statements issued by GAAP-compliant entities and safely assume consistency, which allows for quick and accurate cross-company comparisons.

Because GAAP standards deliver transparency and continuity, they enable investors and stakeholders to make sound, evidence-based decisions. The consistency of GAAP compliance also allows companies to more easily evaluate strategic business options.

What Are the Basic Principles of Accounting?

GAAP incorporates three components that eliminate misleading accounting and financial reporting practices: 10 accounting principles, FASB rules and standards, and generally accepted industry practices.

These components create consistent accounting and reporting standards, which provide prospective and existing investors with reliable methods of evaluating an organization's financial standing. Without GAAP, accountants could use misleading methods to paint a deceptive picture of a company or organization's financial standing.

GAAP consists of these three parts:

These 10 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.

The FASB issues an officially endorsed, regularly updated compendium of principles known as the FASB Accounting Standards Codification. The compendium includes standards based on the best practices previously established by the APB. These organizations are rooted in historic regulations governing financial reporting, which the federal government implemented following the 1929 stock market crash that triggered the Great Depression.

All organizations do not follow the GAAP model. Rather, particular

businesses follow industry-specific best practices designed to reflect the nuances and complexities of different business areas. For example, banks operate using different accounting and financial reporting methods than those used by retail businesses.

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