Generally Accepted Accounting Principles: The Big GAAP vs. Little GAAP Debate

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Generally Accepted Accounting Principles, or GAAP, is considered to be the standard for financial accounting in the U.S. GAAP is used to guide accountants through the business of recording, summarizing, and preparing financial statements.

One of the most hotly contested issues over the past three decades regarding the development and application of GAAP is the matter of private versus public companies. It has been noted that many of the GAAP elements that apply to public companies have lesser utility for private ones. Many owners of privately held businesses simply find GAAP too complex or unnecessary, and thus opt not to use it.

This debate has led to an ongoing conversation which is often referred to as "Little GAAP vs. Big GAAP." In March 2005, a task force was assembled by the Board of Directors of the American Institute of Certified Accountants (AICPA) to research the issues encountered in private company financial reporting. When the report was released, it was unanimously recommended that processes be established that evaluate changes made to GAAP to make sure that it will be not unduly burdensome to apply to private company financial reporting.

While current differences between the two concepts are not major, certain differences do exist. For example, earnings per share (EPS) is not a required disclosure for private companies—only public ones.

The argument against having a "Big GAAP" and a "Little GAAP" is that many accountants believe that having two separate standards would lead to confusion and the possibility of financial statements being assembled to "lesser" standards.

Ever since the committee in 2005 made the recommendation to separate Little GAAP from Big GAAP, there has been controversy surrounding this issue.

The Differences Between Big GAAP and Little GAAP

The issue of what to do with GAAP—if it or how it should be applied equally to both public and private companies—is still a very much discussed subject. While the arguments surrounding GAAP will likely be continuing for some time, there have been some decisive steps made.

To begin, current GAAP has primarily been issued by the Financial Accounting Standards Board, or the FASB. This is a non-profit organization created by the accounting profession to carry out the rules of GAAP and also to amend them as the world financial situation requires.

In order to address the issues identified by the AICPA task force in 2005, the FASB established the Private Company Financial Reporting Committee (PCFRC). The idea behind the creation of PCFRC is that it would help create standards for private companies that would improve the quality and consistency of reporting.

PCFRC was formed in 2008, and in 2010 it issued a statement recommending the use of the International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs).

IFRS for SMEs

Originally issued in 2009, IFRS for SMEs guidelines are meant to be used by companies that don't have publicly traded stocks or debt and have no holdings in a fiduciary capacity (i.e., banks, credit unions, broker/dealers, or other similar entities). IFRS for SMEs guidelines tend to be less than 500 pages in length.

IFRS for SMEs guidelines are positive for smaller businesses, which are generally more interested in information pertaining to cash flow, liquidity and profitability. Given that most small to medium-sized businesses lack interest in the information necessary to create earnings forecasts or trend analysis, IFRS for SMEs offers small to medium business owners an attractive option when it comes to financial reporting. They do not require the application of standards that may not apply to smaller businesses, and they were formulated to reduce the time and costs associated with preparing financial statements.

IFRS for SMEs is just one of many ways that the FASB is working to improve reporting conditions in both small and large businesses alike. Time will tell whether the idea of Big and Little GAAP gains traction, or if the U.S. will switch over to IFRS.

In Summary

GAAP governs the preparation of financial statements for all businesses. However, as these rules are often considered cumbersome to smaller businesses, new solutions are being devised.

- One of the most hotly contested issues over the past three decades regarding the development and application of GAAP is the matter of private vs. public companies.
- When the 2005 AICPA report was released, it was recommended that a separate list of reporting rules for small to mid-size businesses be adopted.
- Some professionals believe that separating GAAP into Big GAAP and Little GAAP could cause inconsistency in reporting.
- PCFRC suggested that IFRS for SMEs be used for small to medium businesses to make financial reporting easier.

The application of GAAP is often described as complex and confusing. It, therefore, is an area where Los Angeles executives may want to engage with an outsourced CFO services firm for interpretation and implementation.

References and Further Reading

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