THE NEW APPROACH to Financial Accounting, Auditing, and Reporting
Financial Accounting and Reporting Methods

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Overview

The primary focus of this discussion is on small business owners and small local governments. We want you to truly understand 1) why financial accounting and reporting is so complicated, and 2) how financial accounting and reporting can be unbelievably simplified.

Why the focus on small businesses and small local governments? As explained below, these two groups have been somewhat neglected with regard to “generally accepted” financial accounting and reporting. They are expected to employ the same accounting procedures and the same financial reporting rules and guidelines that are expected, or required, of big business and big government.

This expectation is not, by itself, a problem. It becomes a problem when the financial accounting procedures are burdensome, and the related financial statements and reports do not support the entity’s financial reporting needs. The problem is compounded when the related costs become prohibitive.

Small businesses and small local governments, in comparison to their “big” counterparts, are neglected in the sense that they do not have “generally accepted” **alternative** financial accounting and reporting options, and their resources are more limited. Given the overwhelming number of accounting entities involved, these observations rise to a disturbing level.

Small Businesses. For example, about three out of four business owners report their business taxable income as a part of their personal tax return. These **business owners do not have “generally accepted” alternative financial accounting and reporting options** to simultaneously support their day-to-day financial reporting needs and their annual taxable income reporting requirements.

Small Local Governments. The numbers are staggering for local governments. Virtually all local governments are subject to budgetary compliance accounting and reporting requirements for legal annual budgets, requirements that vary from state to state. Easily the most common and the most important statutory compliance requirement across the nation is “encumbrance” accounting. This concept has been around for more than 100 years, yet still presents a major accounting problem for all state and local governments, not just small local governments. The problem is that **governmental entities simply do not have “generally accepted” alternative financial accounting and reporting options** to simultaneously support their day-to-day financial reporting needs and their compliance reporting requirements.

Encumbrance Accounting. The concept of encumbrance accounting deserves special attention because of its importance to all accounting entities and almost complete lack of attention by the financial accounting community. It is a day-to-day financial accounting requirement for virtually all governmental entities, and no less important to business owners. Despite its importance, encumbrance accounting is, at best, poorly understood by a vast majority of the financial accounting community.

What is encumbrance accounting? In governmental circles, encumbrance is defined as "a commitment related to unperformed (executory) contracts for goods or services." It is sometimes referred to as a "legal commitment" to emphasize its legally-binding nature.

Why is encumbrance accounting important? Typical encumbrances include outstanding purchase orders and contractual agreements. They are not liabilities unless and until the related goods or services have been delivered to the entity. In a very real sense, they are cash disbursements just waiting to be paid. It is only prudent that encumbrances be recorded on a day-to-day basis in the financial accounting. Absent this daily accounting and reporting capability, the accounting entity cannot effectively monitor potential cash needs in the near and distant future.

What is the importance to local governments? Most state and local governments are subject to a legal annual budget that requires encumbrance accounting to demonstrate legal budgetary compliance. That is, the governmental entity cannot spend, or make a legal commitment to spend, unless two conditions have been met **at the time of the commitment** – 1) sufficient uncommitted (unencumbered) cash must be available, and 2) sufficient budgetary expenditure authority must be available. If either or both conditions have not been met, the legal commitment itself will be null and void because a state law has been violated. Because the budgetary compliance requirements must be applied as of the date of the transaction, the accounting system must be capable of continuously monitoring 1) the remaining budgetary expenditure limitation, and 2) the unencumbered cash balance.

What is the importance to business owners? While business owners do not have the budgetary compliance requirement to monitor outstanding legal commitments (i.e., encumbrances), they do indeed have legal commitments for which cash disbursements are just waiting to be paid. Financial statements and reports identifying such outstanding encumbrances would enhance the business owner's decision-making capabilities.

Why is encumbrance accounting poorly understood? Encumbrance accounting is poorly understood because it has never been effectively implemented. Virtually all traditional financial accounting systems are designed around the standard business reporting model – accrual basis balance sheet and income statement. These traditional accounting systems employ the double entry method of bookkeeping and standard double entry accounting. Such financial accounting systems, designed for such financial statements, are not compatible with **day-to-day** monitoring of the remaining budgetary expenditure limitation and available cash (i.e., unencumbered cash).

Our Case. We want to make the case that the current financial accounting and reporting culture is not addressing the needs of its entire constituency. That constituency includes all financial accounting entities, large and small.

First, the financial accounting and reporting needs of the vast majority of accounting entities get minimal, if any, attention. This means academia and countless stakeholder organizations are doing little or nothing to promote "generally accepted" financial accounting and reporting for the vast majority of financial accounting entities.

Second, even those entities that do receive financial **reporting** support in the form of generally accepted accounting principles (GAAP), are confronted with financial **accounting** technology that does not meet their entire range of financial reporting needs.

The discussion that follows is somewhat technical in nature, but our intent is to distinguish The New Approach (NA), with its new financial accounting and reporting technology, from old technology. If you understand present-day state-of-the-art financial accounting and reporting, you will much better appreciate how NA for Business and NA for Government can change your accounting experience from a headache to a day in the park.

NA's new technology makes accounting simple to understand and simple to maintain, even for non-accountants. You will experience never-before-seen accuracy, reliability, and financial reporting options.

Financial Accounting and Reporting Methodology

Today's financial accounting and reporting domain contains **two different methodologies – 1) the Business Methodology, and 2) the Governmental Methodology**. Each methodology has its own independent authoritative body, the Financial Accounting Standards Board (FASB) for Business and the Governmental Accounting Standards Board (GASB) for Government. Authoritatively speaking, the two bodies are independent of each other. Also, both methodologies are supported by non-authoritative bodies, including academia and many independent organizations that represent the interests of different groups of stakeholders.

Each methodology has two core components – 1) Financial Accounting, and 2) Financial Reporting. The **Financial Accounting component functions** to record, store, and translate the day-to-day financial transactions into financial statements and reports for the accounting entity. The **Financial Reporting component comprises** a set of financial statements prepared in accordance with the rules and guidelines promulgated by the related authoritative body (i.e., FASB and GASB).

- **Financial Accounting Component.** Both the Business Methodology and the Governmental Methodology employ the same basic accounting technology – the Double Entry Method of Bookkeeping, commonly referred to as **Double Entry Accounting**.

  Double entry accounting is characterized by double entry posting of journal transactions to the general ledger, as well as postings to subsidiary ledgers for certain types of transactions. Depending on the entity, it might have subsidiary ledgers such as an Accounts Receivable ledger, an Accounts Payable ledger, or a Fixed Assets ledger.

- **Financial Reporting Component.** The financial reporting rules and guidelines that apply to each of the two methodologies are collectively referred to as **generally accepted accounting principles, or GAAP**. GAAP for the Business Methodology is substantially different, and substantially less complicated, than GAAP for the Governmental Methodology.

  Business GAAP Financial Statements. Business GAAP financial statements are comprised of two companion statements prepared using the accrual basis of accounting – 1) balance sheet, and 2) income statement. The balance sheet is a statement of financial position. The income statement is a statement of operating results. **In summary:**

ABOA = Accrual Basis of Accounting

1) Balance Sheet (ABOA) – Statement of Financial Position
   Income Statement (ABOA) – Statement of Operating Results

Governmental GAAP Financial Statements. Governmental GAAP financial statements are comprised of a complex set of statements prepared using multiple bases of accounting. **In summary:**

ABOA = Accrual Basis of Accounting
BBOA = Budgetary Basis of Accounting

1) Government-Wide Statement of Net Assets (ABOA)
   Government-Wide Statement of Activities (ABOA)

2) Governmental Fund Balance Sheet (Modified ABOA)
   Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances (Modified ABOA)
   Budgetary Comparison Statement (BBOA)

3) Proprietary Fund Statement of Net Assets (ABOA)
   Proprietary Fund Statement of Revenues, Expenses, and Changes in Fund Net Assets (ABOA)
   Proprietary Fund Statement of Cash Flows

4) Fiduciary Fund Statement of Fiduciary Net Assets (ABOA)
   Fiduciary Fund Statement of Changes in Fiduciary Net Assets (ABOA)

What is Basis of Accounting? Basis of accounting refers to the “accounting principles” applied to financial transactions for the purpose of recognizing revenues and expenses in the financial statements (e.g., income statement). There are two “primary” bases of accounting – 1) cash basis of accounting (CBOA), and 2) accrual basis of accounting (ABOA).

Cash basis is on the simple end of the spectrum, while accrual basis is on the complex end of the spectrum. In between these two primary bases of accounting are additional bases of accounting, each with its own set of rules that describe how revenues and expenses are recognized. Most of these inbetweeners are modifications of one of the primary bases of accounting, Cash Basis or Accrual Basis.

Some “modified” bases of accounting are supported by FASB and GASB as GAAP; some are supported by another “authoritative” body (e.g., IRS, SEC, state law). In any case, a description of the basis of accounting is (or should be) made clear to the user of the related financial statements.

Each basis of accounting typically has its own specialized reporting purpose. Also, each basis typically will be contain specifically identified modifications to either cash basis or accrual basis and be referred to as Modified Cash Basis of Accounting or Modified Accrual Basis of Accounting.

These modified bases of accounting are commonly given a generic name that is easily interpreted by the **intended user** of the related financial statements. Budgetary basis of accounting (BBOA) is commonly used for local government financial statements that are prepared in accordance with state budgetary compliance reporting requirements. What is referred to as BBOA in one state might be called Regulatory Basis of Accounting, or it might be described as "Modified CBOA, modified for the inclusion of encumbrances." All three naming conventions might mean the same thing, but just referenced differently.

Commitment basis of accounting is basically the equivalent of "Encumbrance" basis of accounting. Commitment basis and Encumbrance basis can be a source of confusion, especially if the two terms are used interchangeably. To avoid confusion, the following comparisons might help:

Commitment Basis of Accounting. The term "Commitment Basis" applies to business financial reporting. Commitment basis financial information is not "specifically" presented in the basic business GAAP financial statements. Rather, Commitment basis financial information is a GAAP disclosure requirement of outstanding legal commitments.

Encumbrance Basis of Accounting. The term "Encumbrance Basis" applies to government financial reporting. Encumbrance basis financial information is typically a financial reporting requirement to demonstrate compliance with statutory "balanced budget" requirements. This reporting requirement usually takes the form of a financial statement in government reporting, as opposed to a disclosure requirement for legal commitments in business reporting.

Importance of Commitment Basis. The legal reporting requirement for Encumbrance compliance reporting speaks volumes of its importance, especially continuous (day to day) monitoring. Such day-to-day monitoring is no less important for business reporting, particularly to plan for future cash flow needs, both near-term and long-term.

Emphasis Added: Commitment (Encumbrance) Basis tracks (monitors) LEGAL commitments. Legal commitments are very common in both business and government, yet both the business methodology and the governmental methodology give this basis of accounting scant attention, at best.

GAAP Financial Statements Often Audited. Financial statements prepared in accordance with GAAP provide a degree of uniformity and comparability from entity to entity. Such statements also provide assurance that the preparer of the statements and the user of the statements are on the same page regarding how the statements are prepared. However, the reader of the statements has limited assurance that the statements were, in fact, prepared in accordance GAAP. Hence, GAAP financial statements are often subjected to a financial statement audit by an independent auditor for such assurance.

Origin and Present Status of Business and Governmental Methodologies

- **Business Methodology – Origin and Present Status**. The Business Methodology had its beginning five centuries ago. It started with the double entry method of bookkeeping and a statement of financial position (balance sheet). The double entry accounting system has been generally recognized to this day as the gold standard of financial accounting. The financial statement reporting model has evolved into two companion financial statements –

a balance sheet and an income statement – prepared using the accrual basis of accounting.

The double entry method of bookkeeping has worked well for the standard business financial statement reporting model – accrual-based balance sheet and income statement. It is deficient, however, in some areas. It is extremely limited in its financial reporting capability. It is designed to prepare GAAP financial statements, and that is all. For example, it is not designed to prepare GAAP accrual basis financial statements **and** tax accrual basis income statement simultaneously because taxable income uses a different basis of accounting than that used for GAAP reporting. There are other issues related to insufficient controls regarding data integrity and auditability of underlying financial data. Perhaps the single biggest issue is its complexity. Even for the smallest and simplest of businesses a double entry accounting system could not be maintained without an accountant with appropriate education, training, and experience.

- **Governmental Methodology – Origin and Present Status**. The Governmental Methodology had its beginning more than a century ago. Similar to the Business Methodology, the Governmental Methodology started with the double entry method of bookkeeping, and that has not changed. However, the governmental financial statement reporting model has continually evolved, the last major change being about two decades ago. It is significantly more complex than the business model in that it requires several sets of financial statements, each using a different basis of accounting, one of which is the accrual basis of accounting.

  Contributing to the complexity of governmental financial reporting has been the introduction of entirely **new** financial accounting and reporting **concepts** that remain to this day. These **New Concepts** include **fund accounting and reporting, and encumbrance accounting and reporting**. Neither of these new concepts are supported in the Business Methodology.

  The double entry method of bookkeeping has NOT worked well for the standard governmental financial statement reporting model from day one. The complexity of the financial statements as a whole, both to prepare them and to even understand them, borders on unacceptability. A non-authoritative book designed to provide guidance on governmental financial accounting and reporting is nearly 700 pages. Much of the guidance is so complex as to be impractical to implement.

  Governmental GAAP can be characterized as accounting principles, but calling them “generally accepted” is by name only. The reason governmental GAAP is accepted at all is because there is only one governmental GAAP to choose from. The fact is, the vast majority of local governments across the nation are without a “generally accepted” financial reporting model.

  Important: Please understand the intent of the above comments. The original **New Concepts** in governmental financial accounting and reporting are technically correct, but implementation is difficult, if not impossible.

Non-GAAP Financial Reporting – Business and Governmental

What do we mean by “non-GAAP financial reporting”? Non-GAAP reporting refers to financial statements other than those required by GAAP. For example, for businesses, this means financial statements other than the balance sheet and income statement prepared using the accrual basis of accounting.

The vast majority of accounting entities, both business and government, are not "required" to prepare GAAP financial statements. Accordingly, most of these entities do not prepare GAAP statements because **they believe the cost outweighs the benefits**. This belief is clearly founded in complicated accounting procedures, complicated financial reporting, and excessive accounting and auditing costs. It is evident in both the business methodology and the governmental methodology, but most pervasive in the governmental area.

- **Governmental Methodology Is More than Just Complicated.** The governmental methodology supports financial accounting procedures that are impractical (basically impossible) and financial reporting that is of questionable value. For starters, we could discuss the financial accounting and reporting for modified accrual based financial reporting, and budgetary reporting, but we do not have the space or inclination to discuss it here!

- **Methodologies Are NOT Conducive to Non-GAAP Financial Reporting Needs.** Both the business methodology and the governmental methodology are, by design, centered around **external** financial reporting needs which is the intent of GAAP financial statements. The intent is not sinister in nature, but sinister in effect because 1) they are both focused primarily, if not exclusively, on **annual** financial reporting, and 2) by default, both methodologies focus on the double entry method of bookkeeping to implement the GAAP reporting requirements.

  In this respect, both methodologies are counter-productive to internal (management) financial accounting and reporting needs on a day-to-day, week-to-week, and month-to-month basis. They are also counter-productive to other (non-GAAP) external financial reporting requirements.

- **Methodologies are Counter-Productive.** Both the business methodology and the governmental methodology are counter-productive when you consider the overall domain of financial accounting and reporting. To explain this comment, we will start by placing all financial accounting entities into two groups – the GAAP Group and the Non-GAAP Group. The entities in the GAAP Group include business and governmental entities who are required to prepare GAAP financial statements. All other entities are in the Non-GAAP Group.

  The distinction between the two groups is 1) those entities **required** to prepare GAAP statements (GAAP Group), and 2) those **not required** to prepare GAAP statements (Non-GAAP Group). Clearly virtually all of those entities in the GAAP Group are subject to other, non-GAAP, legal financial statement reporting requirements. All entities in the Non-GAAP group have the option, but are not required, to prepare GAAP statements.

  GAAP Group. The business entities must follow the business methodology, and the governmental entities must follow the governmental methodology. The problem the GAAP Group is confronted with is that the methodology is focused only on its specific financial accounting and reporting model. And effectively that means at the expense of other, non-GAAP financial reporting capabilities that are not built into the methodology. This makes it difficult, or near impossible, to fulfill other legally required financial reporting. For example:

Business GAAP Group – Taxable Income Accounting and Reporting. To cite a specific example, businesses are required to prepare a statement of income, showing taxable income and related deductible expenses, for purposes of preparing an income tax return. Such a statement must be prepared on an appropriate TAX basis of accounting, such as the tax cash basis of accounting or the tax accrual basis of accounting. A GAAP income statement is not acceptable for income tax reporting purposes. The Business Methodology does not have a “convenient” provision to support any type of tax basis of accounting.

Governmental GAAP Group – Budgetary (Encumbrance) Accounting and Reporting. To cite a specific example, most state and local governments are subject to a legal annual budget that requires encumbrance accounting to demonstrate legal budgetary compliance. This budgetary compliance reporting generally focuses on two compliance requirements. The governmental entity cannot spend, or make a legal commitment to spend, unless two conditions have been met at the time of the commitment – 1) sufficient uncommitted (unencumbered) cash must be available, and 2) sufficient budgetary expenditure authority must be available. Guidance for encumbrance accounting is available in the non-authoritative literature, but it is integrated into the governmental methodology. As a consequence, the guidance is so complex as to be impractical to implement.

Non-GAAP Group. Embedded within most, perhaps all, **comprehensive** financial accounting and reporting systems is either the business methodology or the governmental methodology. Hence, they employ the double entry method of bookkeeping, and their focus is GAAP financial reporting requirements. This is the problem that confronts the Non-GAAP Group.

The business methodology and the governmental methodology are both singularly focused on GAAP financial accounting and reporting. This in turn, at least in a practical sense, eliminates the capability of using such systems for non-GAAP alternative financial reporting requirements. Historically speaking, this problem has been particularly burdensome to small businesses and small local governments mostly due to their much more limited resources. And despite the significance of their numbers, minimal research and development efforts have been directed to help them. And, of course, the results have been equally minimal.

Do we create yet another financial accounting and reporting methodology for Tax Cash Basis of Accounting? Do we create yet another financial accounting and reporting methodology for Tax Accrual Basis of Accounting? Do we create yet another financial accounting and reporting methodology for Governmental Budgetary Basis of Accounting?

The answer to these questions is, probably not. As we have seen historically, creating a financial accounting and reporting methodology certainly does not mean it will have general acceptance.

The better approach might be to study consolidation of financial accounting and reporting methodologies. Whatever happens, we believe with relative certainty that our new technology, as demonstrated with The New Approach, will be in the forefront.

The New Approach vs. The Old Approach

Given the new technological advances of The New Approach, I can say unequivocally that the single biggest problem confronting the world of financial accounting, auditing, and reporting is the over-reliance on the double entry method of bookkeeping. The following analytical comparison of The New Approach and The Old Approach is intended to illustrate my point.

- **Financial Accounting.** Every accounting professor, at every university, every accountant, every auditor, will tell you there is a gold standard of financial accounting: **Double Entry Accounting**.

  Problem. Double entry accounting is so named because it requires double entry posting of all journal transactions to the general ledger. Some of the same transactions must also be posted to subsidiary ledgers. Double entry accounting systems are time-consuming, and so complicated a trained and experienced accountant is required for day-to-day maintenance.

  Remedy. The New Approach completely eliminates double entry posting of journal transactions to the general ledger. It also eliminates postings to subsidiary ledgers. It is so simple to administer a non-accountant can handle day to day maintenance with ease.

  Emphasis Added. The **remedy is totally without sacrifice**. Quite the opposite, the business owner or local government will literally be shocked to see:

  1) huge cost savings,
  2) expanded financial statement reporting capabilities, not possible with any other financial accounting system, and never before seen in the business world, and
  3) a unique new approach to financial auditing that protects the business owner in ways not otherwise possible.

- **Financial Reporting.** Every accounting professor, at every university, every accountant, every auditor, will tell you there is a gold standard of financial reporting: **GAAP accrual basis financial statements (balance sheet and income statement)**.

  Problem. Coupled with the gold standard of financial accounting, the business owner gets GAAP statements, but little else, and that is the problem. By deliberate design, the purpose of GAAP statements is more to help the investor or lender, than to help the business owner manage the business day to day. To add insult to injury, the business owner, must first pay to prepare the statements, then must pay to have them audited, because the users cannot otherwise rely on them. The business owner must then pay to prepare statements for taxable income and related deductible expenses.

  The Take-Away: the so-called gold standards of financial accounting and reporting are absolutely NOT what the average owner of a small business wants or needs, or can even afford. The problem is **NOT** GAAP financial statements. The problem is the cost, the cost benefit ratio, and financial statement reporting priorities (or the lack thereof).

  Remedy. The New Approach, almost incredibly, has the **total solution** for nearly ALL business owners (and local governments):

  1) Simple, economical accounting system.

2) Financial statement and reporting capability that serves virtually all needs of the business owner (and local government), including tax accrual basis statements and tax cash basis statements for the business owner, and all of which are simple and economical to prepare.
3) This is a **total solution**, not a little piece of the pie.

- **Financial Auditing.** Every accounting professor, at every university, every accountant, every auditor, will tell you that a financial audit is an independent, third-party (CPA) examination of a company's financial statements to check for accuracy and full disclosure of financial activities and claims presented in the statements.

  Problem. Financial auditing is viewed almost universally in the context of an audit of the year-end financial statements. Not surprisingly, it is also viewed almost universally as the best approach to address fraudulent financial statement reporting, which almost always accompanies embezzlements.

  Unfortunately, there is some factual basis for this type of thinking, especially when a financial statement audit is viewed in the context of 1) double entry accounting, and 2) GAAP financial statements. This is a worst-case scenario for the owner of a small business:

  1) Double entry accounting does not lend itself to effective auditability on a day-to-day basis.
  2) The purpose of GAAP financial statements is more to help the investor or lender than to help the business owner manage day-to-day business operations.
  3) Studies have shown that year-end financial statement audits are not a very effective or reliable tool for prevention and detection of fraudulent financial reporting and embezzlements.

  Remedy. The New Approach, almost incredibly, has the total solution for nearly ALL business owners (and local governments). First and foremost, it focuses on fraud prevention and fraud detection using auditing technology within the accounting system. From the moment a tiny financial transaction takes place, the audit procedures are ready and actively working even before the transaction is recorded in the data warehouse. The monitoring of transactional data never stops. The focus on fraud prevention and early detection is continuous, and employs verifiable financial reporting. This effectively gives the business owner day-to-day auditability not possible in any other system:

  1) Accounting system-based auditability (not possible in any other system), which operates both automatically in the background, and with simple, economical procedures.
  2) Electronic internal controls are integrated into, and they permeate the entire accounting system.
  3) Strategic simple reconciliation procedures are on-going, daily, monthly, and annually.
  4) Regression auditing capability.
  5) Month-End Risk Analysis.

  These accounting system-based auditing techniques are, quite simply, more timely and more effective than the standard year-end CPA financial statement audit for prevention, detection, and rooting out fraudulent financial reporting and embezzlements. To go one step further, The New Approach demonstrably has the highest level of Manageable Auditability of any accounting system ever developed.

Important. This "financial auditing comparison" is NOT intended in any way to attack the auditing community or financial statement audits. The intent is to emphasize how The New Approach broadens the meaning of financial auditing from a financial statement audit once a year, to include a sophisticated, audit-oriented, system of internal controls embedded within the accounting system.

Using The New Approach, financial auditing is taking place daily, literally with every single financial transaction. This new concept of auditing coupled with new audit-related financial reporting capabilities, yields at least two significant benefits – 1) much improved accuracy and reliability of the underlying data supporting the financial statements, and 2) dramatic increases in the level of Manageable Auditability for financial statement audits. More important, the cost of this new fraud prevention and detection is negligible because the related protective measures are integrated within the accounting system. And much of this protection does not even require user intervention.

The New Approach and GAAP – What is the Connection?

Historically speaking, GAAP has been based on the premise that an entity's financial position (i.e., balance sheet) is the most important financial reporting objective for a financial accounting entity. Hence, it has always been coupled with Double Entry Accounting to give us the standard business GAAP financial statement reporting model – accrual basis balance sheet and income statement. Indispensable as GAAP is, it has inherent problems that make it inaccessible for too many! These problems stem substantially, if not entirely, from its coupling to Double Entry Accounting.

In the absence of **The New Approach** to Financial Accounting, Auditing, and Reporting, deficiencies in GAAP + Double Entry Accounting have never been exposed. Obviously, nobody has come up with anything better, even after 500 years. All GAAP-related problems, as discussed below, are addressed in spectacular fashion by The New Approach. That is **THE CONNECTION**!

What are the problems with GAAP?

Please understand that the concept of GAAP is good. However, GAAP coupled with Double Entry Accounting has huge deficiencies, all of which are remedied by The New Approach.

- **Problem 1 – Multiple Variations of GAAP.** The "GAAP Community," however you wish to define it, has given us international GAAP, US GAAP, industry GAAP, governmental GAAP, small business GAAP, and even "GAAP substitutes." So many variations of GAAP are an indication there is no such thing as a universal set of generally accepted accounting principles.

  Should we organize GAAP based on geography? Based on type of entity? Based on size of entity? Based on entity financial reporting requirements? Based on users' needs? The answer to ALL of these questions is Probably Not. What the "GAAP community" has given us is something less than intellectual.

  Question: How do you explain variations of financial position based on variations of GAAP? Worse yet, how do you explain variations of financial position based on variations of the basis of accounting? These are tough questions to answer. It's as if the GAAP community cannot agree on a single basic set of GAAP rules that best represents financial position.

- **Problem 2 – GAAP Decision-Makers vs. GAAP Contributors.** We have too many GAAP contributors with their hands in the cookie jar. Any individual or organized group has the right to be heard. However, the actual decision-makers should be beyond criticism. That is, they should not even have the appearance of a conflict of interest.

  Intellectually speaking, decisions regarding GAAP should ultimately be transparent and generally made NOT just primarily in the interest of investors, lenders, and other stakeholders, but also in the interest of the general public which includes taxpayers, employees, consumers, etc.

  The potential for corruption lies in comments, public or private, by contributing individuals or groups that 1) have undue influence on the decision-making process, AND 2) do not pass the "appearance of a conflict of interest" test.

- **Problem 3 – Financial Accounting.** GAAP financial statements have always been inextricably and exclusively tied to double entry accounting. This leads us to the next problem.

- **Problem 4 – Financial Reporting.** Double entry accounting, traditional as it has been for 500 years, is inextricably and exclusively tied to traditional GAAP financial statements, or a reasonable facsimile thereof, but NOT both. For example, you can have accrual basis financial statements (GAAP). Or, you can have TAX accrual basis financial statements (GAAP substitute). It all depends on whether you want 1) the best representation of financial position, or 2) the best representation of taxable income and deductible expenses. If this makes you feel uncomfortable, then you are normal.

- **Problem 5 – Financial Auditing.** Double entry accounting inherently does not lend itself to effective auditability on a day-to-day basis. Instead it relies on "old-technology" internal controls, such as segregation of duties, coupled with year-end financial statement audits as its most effective tool for prevention, detection, and rooting out fraudulent financial reporting and embezzlements. Unfortunately, virtually all studies have shown that this approach to protection against fraud and embezzlement is at best marginally effective, and least of all cost beneficial.

- **Problem 6 – GAAP Related Costs.** Given the combination of double entry accounting and GAAP financial statements, cost is a significant issue. This alone will steer entities away from GAAP, especially absent a GAAP requirement for the entity.

- **Problem 7 – GAAP for Business Entities.** All business entities have the option to use double entry accounting and prepare GAAP accrual basis financial statements. However, unless they are required to do so, many, perhaps most, are not willing to pay the higher costs. The "GAAP community" has put TAX accrual basis financial statements on the table as a GAAP substitute for consideration by the entity. But why would a financial accounting entity opt to report accrual based taxable income and deductible expenses when they do not even prepare GAAP accrual basis financial statements in the first place?

Concluding Comments

The preparation of GAAP financial statements (e.g., accrual basis balance sheet and income statement) carries with it the considerable burden of double entry accounting. Moreover, GAAP itself is intellectually very weak.

GAAP financial statements are considered, in today's world of financial accounting and reporting, almost exclusively as business accrual basis balance sheet and income statement. Yet there does not exist a universal set of generally accepted accounting principles.

We believe there is merit to different versions of GAAP based on financial statement reporting purpose. This is already being done with different GAAP for different industries.

We also see merit in a simplified version of GAAP that is 1) tailored to small businesses, and 2) the use of which is restricted to financial transactions that are common to 99.9 percent of all businesses. That is one way of eliminating complexity for small businesses. For example, when you have a need to account for 1) mergers and acquisitions, 2) consolidations, 3) intangibles such as goodwill, patents, trademarks, and copyrights, and 5) pension obligations, you would no longer be in the domain of small business.

Suffice to say we need a better way to dispense GAAP into the marketplace. What we are doing now is simply not working effectively for most businesses due to financial accounting and reporting complexity and unaffordability.

We need to shift some of the focus AWAY from GAAP and more toward day-to-day accounting for purposes of fraud protection.