

GAAP Reporting Concepts: Continuing Applications

Building on earlier sections of the comprehensive GAAP guide, this course continues exploring key reporting concepts and their real-world applications. Designed for accounting and tax professionals who want a thorough understanding of GAAP, it reinforces how the standards work together across financial statements. This is a solid choice for practitioners looking to deepen their technical knowledge and stay current with the principles that shape accurate and compliant financial reporting for their clients or organizations.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify options to avoid having to maintain two depreciation schedules.
- Recognize how to account for certain transactions on the statement of cash flows.
- Identify examples of group concentrations.

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Section 1

Chapter Objective

After completing this section, you should be able to:

- Identify options to avoid having to maintain two depreciation schedules.

F. DEPRECIATION AND AMORTIZATION

1. Accounting for Bonus and Section 179 Depreciation in GAAP Financial Statements

Given the enhanced depreciation write-offs for tax purposes under the One Big Beautiful Big Act (OBBBA) of 2025, companies seek ways in which they can maintain one depreciation schedule for both book and tax purposes. This section addresses this option.

Background

One of the more significant business changes made by the OBBBA is an enhancement in the bonus depreciation and Section 179 depreciation amounts. The result is that many companies now have a greater amount of front-loaded depreciation for tax purposes, while those underlying fixed assets continue to be depreciated under GAAP.

Here is a quick review of some of the depreciation changes made by the OBBBA and those carried over from the Tax Cuts and Jobs Act of 2017 (TCJA).

- a. Bonus depreciation: Permanent 100% expensing of certain qualifying fixed assets.
- b. Section 179 depreciation limitation is \$2,500,000 and begins to phase out at \$4,000,000 in 2025, adjusted for inflation.
- c. 100% expensing of cost of qualified production property (QPP) used primarily for manufacturing or production activities.
- d. Depreciation limits are increased for listed property, including motor vehicles.
- e. Qualified leasehold improvements are combined and amortized over 15 years.
- f. Regular tax lives stay the same at 27.5 years for residential property and 39 years for nonresidential property, although Alternative Depreciation System (ADS) lives are shortened.

Because of the opportunities to expense more tangible assets under the bonus and Section 179 depreciation provisions, companies have a larger amount of upfront tax depreciation as compared with GAAP depreciation. This difference leads to temporary differences and deferred income taxes.

Question: Is a company permitted to use MACRS and bonus-Section 179 depreciation for GAAP financial statements?

Response: It depends.

MACRS depreciation may be used for financial statement purposes, provided the MACRS lives and methods are reasonable.

Consider the following chart:

Acceptability of Tax Depreciation for GAAP		
Asset Category	MACRS Lives	Acceptable for GAAP?
Equipment and fixtures	5 to 7 years accelerated	Yes
Residential property	27.5 years straight line	Yes
Non-residential property	39 years straight line	Yes
Listed property	Increased to \$10,000	Possibly- not material
Leasehold improvements	27.5 years or 39 years	No- limited to lease term
Bonus depreciation property	Expensed	No
Section 179 depreciation property	Expensed	No
Expensing of qualified production property (QPP)	Expensed	No

In looking at the previous chart, exclusive of assets that are expensed under bonus and Section 179 depreciation and QPP expensing, the basic MACRS lives are generally consistent with and acceptable for GAAP:

- a. Depreciating equipment and fixtures depreciated over 5 to 7 years on an accelerated basis, is certainly an acceptable systematic and rational allocation of cost under GAAP.
- b. Depreciating residential real estate over 27.5 years and non-residential real estate over 39 years, both on a straight-line basis, is consistent with the method and useful lives of those types of assets under GAAP.

- c. Listed property limits may not be consistent with GAAP, but the differences are generally not material.

That leaves the problem areas of GAAP to include:

- Leasehold improvements depreciation
- Bonus depreciation
- Section 179 property depreciation
- Expensing QPP

In general, use of these four categories of depreciation violates GAAP and do not result in a systematic and rational allocation of cost of the assets' useful lives. The exception is if the result is not materially different than depreciating those assets over their useful lives.

Assuming the difference is material to the financial statements, these items are *not* acceptable for GAAP because they do not result in a systematic and rational allocation of depreciation expense. However, a practitioner can bypass all of these limits based on the results not being materially different from a GAAP method. One last point relates to disclosure. If a practitioner can justify using MACRS, reference should not be made to the MACRS method in the notes to financial statements. Instead, the summary of significant accounting policies should disclose the fact that the company uses an accelerated method based upon certain useful lives. This issue has been a common deficiency found in peer review.

Are there any options under which a company can still avoid having to maintain two depreciation schedules: one for book and one for tax purposes?

Even if an entity has a significant amount of bonus or Section 179 depreciation for tax purposes, and seeks to use the same depreciation for financial statement and tax purposes, there are still a few options available:

Option 1: Consider the depreciation difference not to be material: Record tax depreciation (including the Section 179 deduction and bonus depreciation) for GAAP, based on the argument that the difference is not material.

Option 2: Use a GAAP departure: Record tax depreciation for GAAP and note a GAAP departure in the report.

Option 3: Use tax-basis financial statements: Convert to tax-basis₂₅ financial statements and record tax depreciation under the Internal Revenue Code, including bonus and Section 179 depreciation.

Option 1: Consider the depreciation difference not to be material

The difference between tax and GAAP depreciation may not be material even if there is Section 179 and bonus depreciation, because the amounts expensed under bonus and Section 179 depreciation

might not be material to the financial statements. Expensing of QPP is likely to be material in all instances.

1. If the depreciation difference is not material, tax depreciation is acceptable for GAAP.
2. If a company can justify that, by using MACRS, the difference between the book and tax method is not material, reference should not be made to the MACRS method in the notes to financial statements. Instead, the summary of significant accounting policies should disclose the fact that the company uses an accelerated method based upon certain useful lives.

Option 2: Use a GAAP departure in the accountant's or auditor's report

For many nonpublic companies, it may be prudent to record tax depreciation for GAAP purposes, even if there is a material amount of bonus and Section 179 depreciation or expensing of QPP.

1. If the difference between tax and GAAP depreciation is material, the accountant or auditor can indicate a GAAP departure in his or her report to avoid using two depreciation schedules.
2. In most cases, the departure will not be a concern for third-party users who typically ignore the impact of depreciation and amortization, as they represent non-cash elements of the financial statements.

Sample reports follows:

Compilation Report- SSARS No. 21: Using Tax Depreciation for GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

Boston, Massachusetts

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with the Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

Accounting principles generally accepted in the United States of America require that plant and equipment be depreciated over their useful lives in a systematic and rational manner.

Management has informed us that the Company has computed depreciation in accordance with methods required for federal income tax purposes which do not result in an allocation of depreciation over the assets' estimated useful lives. Management has not determined the effect of this departure on the financial statements.

James J. Fox & Company LLP

Burlington, Massachusetts

March 18, 20X1

Review Report- SSARS No. 25: Using Tax Depreciation for GAAP

Independent Accountant's Review Report

Board of Directors

XYZ Company

Boston, Massachusetts

We have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

Our responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that *should be made to the financial statements for them to*

be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.²⁶

Basis for Qualified Conclusion

As disclosed in Note 2, accounting principles generally accepted in the United States of America require that plant and equipment be depreciated over their useful lives in a systematic and rational manner. Management has informed us that the Company has computed depreciation in accordance with methods required for federal income tax purposes which do not result in an allocation of depreciation over the assets' estimated useful lives. The effects of this departure from generally accepted accounting principles on the Company's financial position, results of operations, and cash flows have not been determined.

Qualified Conclusion

Based on my (our) reviews, **except for the effect of the matter described in the Basis for Qualified Conclusion paragraph**, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

James J. Fox & Company LLP

Burlington, Massachusetts

March 18, 20X1

Audit Report: Using Tax Depreciation for GAAP

Independent Auditor's Report²⁷

Board of Directors

XYZ Company

Boston, Massachusetts

Qualified Opinion

We have audited the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, **except for the effects of the matter described in the Basis for Qualified Opinion section of our report**, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Company as of December 31, 20XX, and the results of its