



## Prepare GAAP Financial Statements

**Business Owner Action Item:** Prepare the Company's financial statements in accordance with GAAP for the past three years.

### What is GAAP?

Generally accepted accounting principles (GAAP) consists of a common set of accounting rules, requirements, and practices issued by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). GAAP standardizes the classifications, assumptions and procedures used in the accounting industry. The purpose is to provide clear, consistent, and comparable information on financial statements. The Buyer will generally only use GAAP financial statements to substantiate the Company's valuation.

### Why should the Company follow GAAP?

Following GAAP ensures financial information is consistently and accurately reported. GAAP financial statements communicate to the Buyer that the business owner is prepared to be acquired and the Company has been managed effectively.

### Which Financial Statements are Required under GAAP?

GAAP requires the (i) income statement, (ii) the balance sheet, and (iii) the cash flow statement.

The **income statement** primarily focuses on a company's revenues and expenses during a particular period (usually a calendar year). Once expenses are subtracted from revenues, the statement produces a company's profit figure called net income.

The **balance sheet** provides an overview of assets, liabilities, and shareholders' equity as a snapshot in time.

The **cash flow statement** measures how well a company generates cash to pay its debt obligations, fund its operating expenses, and fund investments.

### Why is This Important?

- The Buyer will request financial statements prepared in accordance with GAAP during its financial due diligence of the Company.
- The business owner and the Company will represent, warrant, and covenant to the Buyer that the financial statements are prepared in accordance with GAAP.
- The financial statements prepared in accordance with GAAP are the basis for the initial valuation of the Company.

**In My Experience:** The Company's previously prepared financial statements are not prepared in accordance with GAAP and are deficient to present to a prospective buyer.