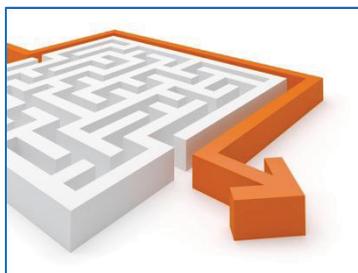




## PRIVATE COMPANY FINANCIAL REPORTING



During 2010, the Blue Ribbon Panel on Private Company Financial Reporting explored the changes necessary to best meet the needs of U.S. users of private company financial statements. In January 2011, the panel, which was sponsored by the AICPA, the Financial Accounting Foundation (FAF, which oversees the Financial Accounting Standards Board and the Governmental Accounting Standards Board) and the National Association of State Boards of Accountancy (NASBA), finalized its recommendations on the future of standard setting for private companies and submitted a report to FAF. FAF Trustees discussed the report at a meeting in February.

FAF has since formed a Trustee Working Group to address accounting standard setting for nonpublic entities (including nonprofits, which the panel specifically excluded). FAF said it will gather input from stakeholders and advisory and constituent groups through surveys, roundtables, meetings and other vehicles. It anticipates issuing an action plan in fall 2011.

FAF may also release a proposal for public comment, likely this spring. It's critically important that CPAs, their clients, small businesses and their financial statement users, especially bankers/lenders, participate in the process and help effect the historic change needed in financial reporting.

The panel's two most significant recommendations are:

- A new, separate board with standard-setting authority be established under the oversight of FAF. The board would coordinate activities with the FASB.
- Changes and modifications be made to existing GAAP that recognize the unique needs of users of private company financial statements. All such changes would reside in the *FASB Accounting Standards Codification*®.

## **Why this effort is so important**

Private companies play a vital role in our economy. There are approximately 29 million private and nonprofit companies in the United States, including 7 million small- to medium-size businesses. CPAs who serve these companies, or who work in them, have been saying for a long, long time that these businesses have financial information needs that are much different from those of large public entities. Their financial statement users need straightforward, understandable information that addresses what they need to know – no more, no less. Given private companies' key role in job creation and economic development, it is more vital than ever that their financial statement users and other stakeholders, such as owners of those companies, have the most relevant and useful financial information they can be given.

## **AICPA's position on the panel's main recommendations**

The AICPA believes change in financial reporting for private companies is long overdue and that a separate standard-setting board is necessary for effective private company reporting to become a reality.

## **A separate board is critical to having private company accounting standards**

Years of studies and research, a joint advisory committee with the FASB (the Private Company Financial Reporting Committee), private company constituent representation on the FASB Board and comment letters in the past, have not yielded meaningful results. The AICPA believes it is imperative that there be a board made up of private company constituents who would set the different standards affecting the private company financial reporting system. As it stands now, issues affecting public companies are what drive accounting standards and impact how they are written. The FASB would continue to set standards for public companies.

## **Private company financial statement users agree change is needed**

Many constituents - including lenders, investors and owners - question the relevance and usefulness of a number of current GAAP standards as they relate to private companies. In fact, the panel listened to users at its very first meeting and this group was also represented on the panel. Users appreciate that certain standards need to change to bring balance to the cost-benefit equation.

## **Examples of standards not appropriate for private companies**

The standard formerly known as FIN 48, on uncertainty in income taxes, is an excellent example, one that many CPAs and companies have wrestled with. In this case, and many others, the standard was created because of issues in public company reporting and the related regulatory oversight that accompanies it.

FIN 46R, on consolidation of variable interest entities, is causing numerous unnecessary challenges for private companies. It was created because some public companies found loopholes in the old standards that they were able to work to their advantage. But private

companies do not have similar incentives and pressure to game the system for investors. Still, they are now forced to consolidate common controlled structures that may have been created for tax purposes. This causes so many problems in private company financial statements that we often hear about lenders accepting GAAP exception audit reports so the company can issue a more relevant statement and sidestep FIN 46R altogether. The growing use of such exceptions weakens the relevancy of GAAP.

The rules on goodwill impairment force private companies to assess goodwill assets in business combinations for impairment annually, no matter what the circumstances. To comply, private companies often must perform calculations based on extensive, complicated fair value estimates. And yet, the users of private company financial statements often say they totally ignore goodwill. It's clear that private companies are spending a great deal of time and money developing information that may never actually be used.

### **Cost also is a factor for change**

CPAs are aware that U.S. GAAP has become exceedingly complex and difficult to apply, especially for private companies. Too much of what is included in current financial statements is not useful to private company owners, lenders and investors. As a result, not only is this complexity not cost beneficial, it also can stand in the way of good business decision-making.

For more information and resources, visit [www.aicpa.org/privateGAAP](http://www.aicpa.org/privateGAAP).