

PKF PERSPECTIVES

SEPARATE STANDARD SETTER FOR PRIVATE COMPANIES?

FASB Overseer Considers Proposal for Private Company Financial Reporting

The Financial Accounting Foundation (FAF), the parent organization of the Financial Accounting Standards Board (FASB), recently announced that it is forming a working group to review the adequacy and effectiveness of FASB's efforts in setting standards for the private company and nonprofit sectors.

The working group will consider, as part of this review, a report issued by a Blue-Ribbon Panel on Private Company Financial Reporting (the Panel), recommending a new standard-setting board to establish exceptions and modifications to accounting principles generally accepted in the United States (U.S. GAAP) for private companies, something none of the previous groups examining the issue over the years has proposed.

Brief History

In the February and July 2010 issues of *PKF Perspectives*, we reported on the work of the Panel, which was formed in December 2009 as part of a joint effort by the American Institute of Certified Public Accountants (AICPA), the FAF and the National Association of State Boards of Accountancy (NASBA), to address how accounting standards can best meet the needs of users of U.S. private company financial statements. There is wide concern about a **lack of relevance** of a number of accounting standards for many users of private company financial statements and the **overall level of complexity of U.S. GAAP**. The Panel was charged with providing recommendations on the future of standard-setting for private companies.

In July 2010, the Panel considered seven alternative models based on U.S. GAAP and International Financial Reporting Standards (IFRS), and eliminated from further consideration models based on IFRS, including IFRS for small and medium-sized entities (SMEs), which offer private

companies a significantly slimmed-down version of IFRS.

It was decided to consider further three of the U.S. GAAP-based models and develop two or three hybrid models that are more detailed and focused. The three models advanced for further consideration were:

1. U.S. GAAP with exclusions for private companies, with enhancements.
2. U.S. GAAP as a baseline with public company add-ons.
3. Separate, stand-alone U.S. GAAP based on current U.S. GAAP.

Regardless of the model ultimately recommended, discussion further included whether the FASB should make efforts to set private company accounting standards, whether a restructured FASB with greater private company representation is needed, and/or whether a new separate private company accounting reporting standards-setter, under the oversight of FAF, is needed.

At their final meeting in December 2010, the Panel members expanded on the outline of their recommendations, culminating in the final report issued to the FAF in late January 2011.

The Panel's Report

As stated, the Panel recommended a new standard-setting board and, at least in the near term, the system should focus on making exceptions and modifications to U.S. GAAP for private companies that better respond to the needs of the private company sector rather than move toward a separate, self-contained GAAP for private companies or a wholesale reorganization of GAAP. Recommendations include effecting potential differences from U.S. GAAP, where warranted, in measurement, recognition and presentation - and not just disclosure.

Key features of such a proposed board should include:

1. A close working relationship with the FASB to achieve a coordinated and efficient standard-setting process;
2. Final authority over exceptions and modifications to U.S. GAAP; and
3. A comprehensive review of the new board in three to five years to evaluate its effectiveness and determine whether to maintain it as is, make additional process improvements, or sunset it.

A further proposal is to create a differential framework (set of decision criteria) to facilitate a standard setter's ability to make appropriate, justifiable exceptions and modifications.

Finally, the Panel also recommended certain short-term and transitional actions by the FAF and the FASB to provide near-term relief for private companies and help ensure a smooth transition to a new board.

The Way Forward

FAF's Board of Trustees discussed the report at its February 15, 2011 meeting, resulting in the announcement to form the working group, which is the next phase of the FAF's review. The group is expected to issue an action plan in six to eight months on whether or how to devise rules that differ from those of public companies.

The group, consisting of FAF trustees and staff, will conduct outreach to stakeholders through surveys and meetings with constituent groups. In conjunction with obtaining input on the scope of the issues and concerns to be addressed, FAF will seek input on suggested improvements, including the solutions recommended by the Panel.

AICPA President and CEO Barry Melancon urged the working group "to move briskly in making changes to current and future accounting standards that will be more relevant and cost-effective to private company reporting constituencies by establishing a new board as was recommended by the diverse membership of the Blue Ribbon Panel."

Whatever FAF decides will be exposed for public comment.

Of particular interest is that one of the top transitional recommendations by the Panel was to fill one or both of the two FASB positions created in August with individuals who have primarily private company experience. Daryl E. Buck, who served on the Panel during 2010, was named to the FASB on January 14, 2011.

The Critics

Critics of these proposals argue that having a separate standard-setting board for private companies could negatively impact the quality of the standards that emerge. It is also likely that standards will become increasingly different over time, adding rather than reducing, the already complex financial reporting environment in the U.S. There are fears that the proposals could ultimately result in a board that sets private company reporting standards, rather than *establishing exceptions and (minor) modifications* to U.S. GAAP. The enhanced potential for further divergence from international standards is also seen as counterproductive by some.

Many believe that the issues cited by the Panel, such as cost and complexity of financial reporting for private companies, equally apply to public companies. Addressing these concerns in the context of private companies only is perhaps not broad enough, and potentially dilutes any benefits derived from this process.

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