What Have We Accomplished in Private Company Financial Reporting?

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In the United States, there have been concerns for many years that the more complicated environment of the public company has resulted in development of accounting standards that place undue complexity on the financial reporting of private companies. In the last decade, concerns over this issue have resulted in much more than just talk. Significant actions have taken place to address what has come to be known as "Little GAAP" (Generally Accepted Accounting Principles).

In 2006, the accounting profession saw the creation of the Private Company Financial Reporting Committee (PCFRC) as a means to clearly demonstrate the commitment of the profession to consider GAAP issues for private companies. In addition, new non-GAAP alternatives for small- and medium-sized entities have been developed by both the American Institute of Certified Public Accountants (AICPA) and the International Accounting Standards Board (IASB).

While running for presidential office back in 1980, Ronald Reagan asked, "Are you better off than you were four years ago?" That phrase has since become a common question in many political campaigns. The accounting profession is surely asking a similar question: Are we better off than we were a decade ago?

Exhibit 1
Recent Events in Little GAAP Standard Setting

Date	Event
2006	Creation of the Private Company Financial Reporting Committee (PCFRC)
2009	Nationwide Listening Tour of the Financial Accounting Foundation (FAF)
2010	Creation of a Blue Ribbon Panel on Standard Setting for Private Companies
January 2011	Submission of Blue Ribbon Panel Report
March 2011	Working Group from FAF solicits further input from private company stakeholders
October 2011	Public Comment on Plan to Create the Private Company Standards Improvement Council (PCSIC)
May 2012	Creation of the Private Company Council (PCC)
December 2013	Issuance of Private Company Decision-Making Framework
November 2015	Three-Year Review of the Private Company Council – Final Report (FAF)

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Exhibit 2
Private Company Reporting Scenarios

Scenario	Reporting Option	Reasoning
Considering Going Public	GAAP with Private Company Options	Minimizes complexity for private companies while closely following the requirements for public companies.
Comprehensive Reporting	Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs)	Makes use of accrual accounting and historical cost measurement with only targeted financial statement disclosures (Durak, 2013).
Minimal Reporting	Other Comprehensive Bases of Accounting (OCBOA)	Cash basis, modified cash basis and income tax basis can work very well with stakeholders having higher levels of internal knowledge of the reporting company.

The purpose of this article is to consider some of the significant accomplishments in the last decade to better meet the financial reporting needs of the private company. To accomplish this objective, the remainder of this article will consider standard-setting accomplishments for private company GAAP, some private company considerations addressed in GAAP, the financial reporting choices facing the private company and some conclusions about what has been accomplished and what the future holds.

Standard-Setting Accomplishments for Private Company GAAP

The road to considering the views of private company stakeholders in the process of financial reporting has received significant attention and has resulted in a series of important developments in the last decade. Some of those events are summarized in Exhibit 1.

In a jointly sponsored effort by the Financial Accounting Standards Board (FASB) and AICPA, PCFRC was created in 2006 to provide recommendations to FASB in regard to both current and future reporting standards where private company GAAP may need to differ from that of public companies. Brackney and Mautz (2008) pointed out that at that time, "the formation of the PCFRC is, arguably, the most significant development to date in the long-running debate about private company reporting in the United States."

In 2009, the Financial Accounting Foundation (FAF) Board of Trustees sponsored a nationwide "listening tour" to consider views on the independent standard-setting process. This tour provided indications that many Americans felt that FASB was not responsive enough to PCFRC recommendations. A primary reason provided was that the two did not have an agreed upon framework to consider GAAP exceptions or modifications for private companies. Because of these concerns, the FAF Board of Trustees worked in conjunction with AICPA and the National Association of State Boards of Accountancy (NASBA) in 2010 to create a Blue-Ribbon Panel on Standard Setting for Private Companies.

In January 2011, the panel submitted its report to the trustees along with a recommendation that a new and separate standard-setting body be created with authority to provide exceptions or modifications to GAAP for private companies. This was followed by another outreach by a working group of FAF trustees and staff members in March 2011 to solicit further input from various constituents regarding private company financial reporting.

Many of the responses to this outreach made points in support of the Blue Ribbon Panel's recommendation for the establishment of a separate standard-setting board for private companies. In October 2011, FAF solicited public comment for a plan to create the Private Company Standards Improvement Council (PCSIC) "with the authority to identify, propose and vote on specific improvements to U.S. accounting standards for private companies." Any such changes would still be subject to a period of public comment and ratification by FASB (2012, FAF). In comparison to PCFRC, the creation of PCSIC would presumably allow for greater influence in regard to how FASB considered issues regarding private company financial reporting.

The Private Company Council

In May 2012, after careful consideration of the views expressed in the public comments regarding the proposed creation of PCSIC, the FAF Board of Trustees decided to create a body known as the Private Company Council (PCC) to replace PCFRC. To support PCC, the FASB technical director is to assign some of FASB's technical and administrative staff to PCC. Some of these staff serve in a dedicated role while others are to be assigned on an as-needed basis for technical expertise. Two primary responsibilities of PCC include:

1. To determine if exceptions or modifications should be made to GAAP to better meet the needs of the users of private company financial statements:
    a. Recommendations approved by PCC and endorsed by a simple majority of FASB are exposed for public comment.
    b. PCC considers the comments and takes a final vote. Approved recommendations move to FASB for a final decision.
    c. If FASB fails to endorse the recommended change, they are to provide PCC with a written response containing the reasons along with changes that could result in FASB endorsement. Any such response would become a FASB public record.
2. To serve as an advisory body to FASB in considering private company issues for items that are being actively considered in FASB's technical agenda:
    a. While FASB considers items in the technical agenda, PCC can vote to see if there is a consensus regarding private company recommendations for FASB consideration.
    b. Such recommendations are considered in FASB deliberations and must be separately documented as to how they were considered in their conclusions.

A Framework for Little GAAP Decision Making

Another one of the recommendations that arose out of the 2011 report of the Blue Ribbon Panel was that a decision-making framework should exist for considering private companies' issues in regard to establishing or modifying GAAP requirements. After consideration of significant input from various stakeholders, FASB and PCC issued an actual framework in December 2013 titled "Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting of Private Companies." The guide points out that its primary purpose is to determine "whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date and transition guidance for private companies reporting under U.S. GAAP."

Three-Year Review of the Private Company Council

In February 2015, FAF developed a "Request for Comment – Three-Year Review of the Private Company Council," generating 52 comment letters from private company stakeholders. After considering the feedback from this review, FAF issued a final report in November 2015 in which it concluded that "a majority of the stakeholders agreed that the PCC has been successful in addressing the needs of users of private company financial statements."

The FAF trustees also felt that the review indicated that targeted improvements could be made to increase the effectiveness of PCC "without significantly changing the PCC's roles and responsibilities." Some of these targeted improvements include:

1. As the need for a review of existing GAAP declines, PCC should shift more if its efforts to "provide input to FASB during deliberations that lead to a proposed or final standard – rather than developing a private company accounting alternative right after FASB issues a new standard."
2. A requirement that PCC proposals to FASB specifically mention the guide described in the prior section and "how the proposed alternative meets the criteria in the guide, and if it does not, why a departure from the guide is warranted."
3. To provide greater outreach to stakeholders, "PCC or a subset thereof should meet regularly (e.g., annually) with private company stakeholder organizations."
4. Both FASB and PCC should take steps to ensure that private company stakeholders are kept informed regarding "progress made on PCC projects, FASB's consideration of private company alternatives recommended by PCC and input PCC provides FASB on active FASB technical agenda projects."

Private Company Considerations in GAAP

Since the creation of PCC, a number of the GAAP requirements now allow specific considerations that reduce financial reporting complexity for private companies, but still allow them to be in compliance with GAAP. However, PCC does not always feel that the accounting issues brought to its attention should require options that deviate from the traditional GAAP for public companies.

Goodwill Amortization with Simplified Impairment Testing

GAAP requires that goodwill be tested at least annually for impairment and does not allow for amortization of the goodwill. In January 2014, FASB passed a provision allowing a private company to elect an alternative to amortize goodwill for a period of 10 years or less. Under this election, goodwill still is to be tested for impairment upon the occurrence of a triggering event indicating "that the fair value of an entity (or a reporting unit) may be below its carrying amount." This goodwill election assists private companies by removing the requirement for annual impairment testing (FASB Accounting Standards Update No. 2014-02).

Simplified Hedge Accounting for Certain Derivatives

Private companies have stated that many of them find it difficult to obtain fixed-rate borrowing. To deal with this issue, "some private companies enter into a 'receive-variable, pay-fixed' interest rate swap to economically convert their variable-rate borrowing into a fixed-rate borrowing." GAAP considers the swap to be a derivative instrument with the requirement that "an entity recognize all interest-rate swaps on its balance sheet as either assets or liabilities and measure them at fair value." In certain situations, entities can elect to make use of hedge accounting to minimize volatility on the income statement due to changes in the fair value of a swap.

A number of private companies have contended that hedge accounting is difficult to understand and that many of them lack sufficient expertise to meet its requirements. This often results in failure to elect hedge accounting and volatility of income statement results. In January 2014, FASB passed an update that allows "the use of the simplified hedge accounting approach to account for swaps that are entered into for the purpose of economically converting a variable-rate borrowing into a fixed-rate borrowing" (FASB Accounting Standards Update No. 2014-03).

Election to Not Consolidate an Entity Using Variable Interest Entities Guidance

GAAP requires that a company consolidate its financial statements with an entity that it has a controlling financial interest in. This could be indicated by "ownership of a majority of the entity's voting interests" or by applying variable interest entities (VIE) guidance. The VIE guidance indicates a controlling financial interest when a reporting entity "has both: (1) the power to direct the activities that most significantly affect the economic performance of the entity and (2) the obligation to absorb losses or the right to receive benefits of the entity that could potentially be significant to the entity."

In March 2014, FASB passed a provision allowing "a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity if (a) the private company lessee and the lessor entity are under common control, (b) the private company lessee has a lease arrangement with the lessor entity, (c) substantially all of the activities between the private company lessee and the lessor entity are related to leasing activities between those two entities and (d) if the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor entity." Under this election, certain disclosures by the lessee would provide information regarding the lessor entities without the complexity of applying VIE guidance (FASB Accounting Standards Update No. 2014-07).

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Election for Non-recognition of Certain Intangible Assets in a Business Combination

In December 2014, FASB passed an option for private companies to no longer have to recognize certain intangible assets separately from goodwill in a business combination. These certain intangible assets include "(1) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (2) noncompetition agreements" (FASB Accounting Standards Update No. 2014-18).

Lease Accounting Viewpoint

In a letter dated Dec. 2, 2013, PCC responded to an inquiry from FASB as to whether GAAP requirements for leases should be different for private companies. In this instance, PCC turned down an opportunity to create different rules for private companies.

The Choice for Private Companies

Recent developments provide support for the presumption that there are at least three primary types of scenarios in regard to private company financial reporting (see Exhibit 2).

In considering the development of their Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs), AICPA states that: Unlike the tax or cash bases of accounting, the FRF for SMEs framework has undergone public exposure and professional scrutiny and contains explicit and comprehensive accounting principles. These features result in a reliable and consistently applied financial framework.

So … Are We Better Off?

With the continuing development of private company options in GAAP and the FRF for SMEs, is the accounting profession better off than it was a decade ago? Only time can tell if the profession is on the right course. For the following reasons, it is believed that the profession is better off than it was a decade ago:

- Talk was turned into action with the creation of PCFRC. Although replaced by PCC, the profession learned from the experiences of its initial efforts to advise FASB.
- A Private Company Decision-Making Framework has been developed to consider private company exceptions or modifications to GAAP.
- Advisory bodies to FASB have been successful in getting private company considerations addressed in GAAP.
- FASB has agreed to respond to PCC within a reasonable timeframe. In addition, negative responses are to be accompanied by an explanation that opens the dialog to further discussion.
- A financial reporting void may well have been filled between the alternatives of OCBOA and GAAP financial reporting by recognizing the need for AICPA's non-GAAP alternative: Financial Reporting Framework for Small- and Medium-Sized Entities.

In addition, FAF and FASB are indicating that PCC is being viewed as a valuable addition to the standard-setting process. The 2013 FAF annual report contains the following statement: When the PCC puts an issue on the table, FASB has adopted a policy of considering whether the proposed change may make sense for public as well as private companies – along with not-for-profit organizations. We believe this will promote a continued focus on making GAAP simpler and easier to use for all (FAF Annual Report, 2013, p. 7).

Private companies are better off because they now have major input into the standard-setting process and if the above quote is any indication, all companies both public and private may be better off if FASB considers whether the private company exemptions might also be applicable to public companies. ■

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