



Financial Reporting Advisors, LLC
100 North LaSalle Street, Suite 2215
Chicago, Illinois 60602
312.345.9101
www.FinRA.com

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VIA EMAIL TO: PrivateCompanyPlan@f-a-f.org

Financial Accounting Foundation
Board of Trustees
401 Merritt 7
Norwalk, CT 06856-5116

To the Board of Trustees of the Financial Accounting Foundation (the "Foundation"):

Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. Our clients include both large and small public and private companies. We appreciate the opportunity to comment on the Foundation's *Plan to Establish the Private Company Standards Improvement Council* (the "Plan").

Summary Comments

Five observations underlie our views on the Foundation's Plan:

1. US Generally Accepted Accounting Principles ("GAAP") should meet the general purpose, external financial reporting needs of both private and public companies.
2. The focus of the US financial reporting standards-setting process over the past decade or more has been to meet the needs of users of public company financial statements. More attention should be given to the needs of users of private company financial statements and to the concerns expressed by the preparers and auditors of those financial statements.
3. External financial reporting standards for business enterprises should reflect the economics of transactions, regardless of the capital structure of the entity that enters into the transaction. Views may differ regarding how best to reflect the economics of a transaction, but once a standard is established, it should apply to all business enterprises. Thus, while the decision to enter into a transaction and the determination of how to structure it should depend on the objectives, strategies and resources of the entity, the decision of how to account for the transaction should not.
4. Users of general purpose financial statements for business enterprises are best served by a single, consistently applied set of financial reporting standards. The serious and extensive consideration being given to the adoption of International Financial Reporting Standards ("IFRS") by US public

companies is prima facie evidence, in our view, of the very high value users of financial statements place on a single set of high quality accounting standards.

5. Complex transactions yield complex accounting which in turn increases the cost of preparing financial statements. That type of complexity and cost cannot be avoided by an entity that chooses to enter into the transaction. However, complexity in financial reporting and the cost associated with that complexity is also driven by creating special standards for special interests. This type of complexity and cost can be avoided.

On this basis, we strongly disagree with the recommendation of the Blue-Ribbon Panel on Standard Setting for Private Companies (the "Panel") for the creation of a separate private company standard-setting board. Because no laws of nature or universal truths govern financial reporting, it is inevitable that a separate standards setter for private companies will create different standards from those promulgated by the Financial Accounting Standards Board ("FASB"). The result: two US companies will account for the exact same transaction differently solely because one company has more shareholders than the other. We find that result unexplainable and unsustainable.

Over time, a dual reporting framework will increase the complexity and cost of financial reporting in the US, weaken the integrity of both sets of US standards, and diminish the global reputation of US financial reporting. We are disappointed in the current leadership of the American Institute of Certified Public Accountants ("AICPA") for its failure to acknowledge or address these implications of the Panel's recommendation. We are even more disappointed, however, with the reaction of the AICPA's governing council and CEO to the Plan proposed by the Foundation. The AICPA's threat to form a competing standard-setting body if its point of view is not adopted appears to be intended to intimidate other constituencies and to stifle discussion and debate about this critical issue. More evidence of the AICPA's unwillingness to engage in thoughtful debate is the letter-writing campaign it initiated even prior to the Foundation's release of the Plan, followed by another letter-writing campaign after the release of the Plan which it advertises to AICPA members as taking "just 30 seconds" to complete. We admire having passion for a topic and engaging in a constructive, spirited, reasoned debate. We do not admire, or support, the AICPA's tactics.

We applaud the Foundation for the work it has done to understand, explore and debate the recommendations provided by the Panel. The resulting Plan, in our view, was well worth the additional time and effort. We fully support the Foundation's proposal to (a) retain the FASB as the single authoritative standards setter in the US and (b) create a new body within the current standards-setting structure to determine what exceptions or modifications to US GAAP are appropriate to meet the unique needs of users of private company financial statements, to the extent that those unique needs are consistent with the objectives of general purpose financial statements. We believe the Foundation's approach will preserve the integrity and reputation of US GAAP while appropriately incorporating the needs and concerns of private companies. It is a balanced, sensible, professional response to what has needlessly become an emotional issue.

Specific Comments

We would offer the following observations for the Foundation to consider as it moves forward with the Plan:

1. *Private Company Standards Improvement Council* (the "Council") – We suggest deleting the word "improvement" from the name of this group because it suggests a limited life. The Council's

charter is not confined to improving existing standards. Accordingly, its name should reflect the permanence of its role.

2. *Authority* – The Plan states that the criteria for exceptions or modifications to US GAAP for private companies will be developed jointly by the Council and the FASB. Those criteria will then be used by the Council to identify aspects of existing US GAAP that may merit an exception for private companies. It is not clear to us whether these exact same criteria will also be used by the FASB members to ratify or reject changes the Council proposes to US GAAP. Logic would suggest that there should be some differences, if only because the purpose of FASB ratification should be to balance the needs of private company constituents with the overall integrity and objectives of US GAAP.

Addressing any differences in criteria early on will be important not only to the Council's effectiveness but also to the consistency of the FASB's decision making over time as the FASB membership changes. As noted above, our view is that economics, not capital structure, should drive the accounting for transactions. Accordingly, we suggest that the framework for FASB ratification specify that recognition or measurement principles may differ between public and private companies only in very narrow circumstances. This is not to suggest that the Council's criteria should explicitly exclude recognition or measurement issues but rather that the hurdle for obtaining FASB ratification for such differences should be much higher than for transition or disclosure differences.

3. *Critical Responsibilities* – We believe that the most critical aspect of the Council's charter is the development of the criteria it will use to determine whether and when exceptions or modifications to US GAAP are warranted for private companies. In conjunction with this effort, we suggest the Council more clearly define its "private company" constituency. Recognizing that (a) there is no statutory requirement to prepare GAAP financial statements in the US, (b) the size, complexity and resources of private companies are as varied and wide as the size, complexity and resources of public companies, and (c) private companies, unlike public companies, are free to prepare financial statements under a variety of accounting frameworks such as cash basis, tax basis, US GAAP, IFRS or IFRS for Small and Medium Sized Entities, we believe it is necessary to understand the population and characteristics of private companies that prepare US GAAP financial statements when developing the criteria for exceptions or departures from US GAAP. In short, what is the profile of a "private company" for purposes of the Council's work?

Similarly, we believe there is a need to obtain a more comprehensive understanding of the unique needs of private company financial statement users. In looking at the February 2005 AICPA *Private Company Financial Reporting Task Force Report*, for example, it appears to us that the principal focus of the Task Force's research was small private companies. As helpful as that information is, would a survey of the users of financial statements of large private companies report similar results? We note, for example, that in 2008 *Forbes* identified approximately 440 US private companies with revenues of at least \$1 billion; in 2011 it identified over 200 US private companies with revenues of at least \$2 billion. Are the user needs for the financial statements of those very large private companies the same as those of private companies with revenues of less than, say, \$50 million?

Further, absent a comparison with the views of preparers, auditors and users of public company financial statements, it seems difficult to determine which shortcomings of US GAAP are unique to private companies. For example, the 2005 AICPA report referred to above indicated that private

company constituents assigned a low level of usefulness to US GAAP requirements for employer accounting for retirement plans¹. Is that view shared by public company constituents? Similarly, are the “six to ten current standards that cause most, if not all of the problems for private companies” (as noted on page 11 of the Plan) the same standards that cause most of the significant problems for public companies?

4. *Formation and Membership* – We suggest that the Foundation consider whether the first three to four years of the Council’s operation require a slightly different membership structure and commitment than what is indicated in the Plan. In particular, developing the criteria to determine whether and when to modify US GAAP for private companies and then applying these criteria to existing US GAAP would seem to require more time and perhaps even a different skill set than the ongoing operations of the Council. Should the initial membership of the Council include some part-time or full-time members? Should meetings be more frequent than four to six times a year? Should there be a co-chair of the Council in order to insure that the Council Chairman (who is also a full time FASB Board member) is not spread too thin?

We also suggest that the Foundation consider some form of compensation for Council members given that their organizations may be unable to subsidize their employee’s travel costs or otherwise provide their employee with the flexibility and time needed to actively participate in the Council’s activities. As a very small firm ourselves, we are particularly cognizant of the out-of-pocket and opportunity costs of participating in professional activities.

5. *Other Matters* –

- a. We wholeheartedly endorse the creation of a special-purpose committee of Foundation Trustees to oversee the activities of the Council and its interactions with the FASB. However, we are not convinced that this special-purpose committee should have a limited life, as indicated in the Plan. We suggest that the duration of this committee be re-evaluated in three to five years to determine if it should become a standing committee.
- b. We strongly support the inclusion of private company constituents in the post-implementation review process and suggest that the Council be consulted as to the design and execution of the reviews as they relate to private companies.
- c. We encourage the Foundation to consider adding periodic regional roundtables to the Council’s regular meeting schedule. The purpose of these regional roundtables would be to facilitate discussions with and input from private company constituents who are interested in US GAAP and the standards setting process but whose resource constraints limit their active participation.

¹ The Task Force prepared a table illustrating the relevance/decision usefulness of 12 specific US GAAP requirements based on their survey results. Using a scale of 1 (Low), 2 (Medium) and 3 (High), page 16 of the Task Force’s report indicates that “Post retirement [sic] and retirement plans” received a mean score of 1.9 – 2.0 from Owners/Managers, 1.8 – 2.4 from Practitioners in Accounting Firms, and 1.4 – 1.7 from External Stakeholders (including creditors, venture capital firms and sureties.) The scores exclude “Don’t Know” and “Not Applicable” responses.

- d. We strongly encourage the Foundation to require that the Council expose for public comment the specific criteria that the Council plans to use to determine whether and when exceptions or modifications to US GAAP are warranted for private companies. Similarly, an exposure draft and comment process should be followed by the FASB for the framework it plans to use in its ratification decisions.
- e. We foresee a potentially significant benefit from the creation and activities of the Council that is not explicitly identified in the Plan: an improvement in financial reporting for *all* business enterprises. As the Council identifies potential changes that would benefit private companies, the FASB may conclude that the change represents a potential improvement in financial reporting that could benefit all business enterprises. Whether the benefit is a simplified approach to implementing an accounting standard, a less complex approach to accounting for a complex transaction, a more cost effective transition method for adopting a new standard, or more streamlined (or reduced) disclosure, the suggestions made by the Council may apply equally to public companies. The recent FASB projects to review US GAAP for testing goodwill and indefinite lived intangibles for impairment are examples of this outcome. In our view, this benefit to financial reporting as a whole would be much more difficult and costly to achieve if a separate standards setter were created. Further, private companies may find support for their views from the public company preparer, auditor and user community, support that would be difficult to obtain if the FASB were not actively involved in the decision.
- f. We are aware of research regarding the shortcomings of US GAAP for use by private company constituents. Although it may exist, we are not aware of research that comprehensively addresses the alternative principles that would result in more useful financial information for these companies. For example, would some sizeable group of private company constituents find modified cash basis or tax-basis financial information more useful? Given the statistics cited by the Panel regarding the large number of private companies in the US (over 28 million) and the Panel's acknowledgment that many of these companies are very small, it could well be that US GAAP financial statements are not relevant to a significant subset of "privately held companies." We note, for example, that the February 2005 AICPA *Private Company Financial Reporting Task Force Report* found that accrual basis of accounting was not assessed as being highly relevant by some owners, managers, practitioners, creditors and sureties². The AICPA or other interested group could consider exploring whether modified cash or tax-basis financial information would be a useful alternative for these private companies.
- g. Consistent with the notion that modified cash or tax-basis financial information may be a useful and cost-effective alternative for some private companies, the AICPA could potentially assist private companies by developing and codifying guidance for reporting under other comprehensive bases of accounting (so-called "OCBOA"). The objective would be to develop a stand-alone document, for example, a Practice Aid, that would be independent of the attestation literature, more cohesive (and easier to find) than the guidance embedded in the

² The Task Force prepared a table illustrating the relevance/decision usefulness of 12 specific US GAAP requirements based on their survey results. Using a scale of 1 (Low), 2 (Medium) and 3 (High), page 16 of the Task Force's report indicates that "Accrual basis of accounting" received a mean score of 2.5 – 2.7 from Owners/Managers, 2.7 – 2.9 from Practitioners in Accounting Firms, and 2.6 – 2.7 from External Stakeholders (including creditors, venture capital firms and sureties.) The scores exclude "Don't Know" and "Not Applicable" responses.

AICPA's Technical Practice Aids, and more comprehensive than the guidance in the AICPA's publication, *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*. Clarifying what constitutes a "comprehensive" basis of accounting and establishing a framework and principles for presenting financial information and related disclosures on an other comprehensive accounting basis could improve the usefulness and relevance of OCBOA presentations while insuring that the distinction between OCBOA and US GAAP financial statements remains clear.

- h. In light of the Plan set forth by the Trustees, we have limited our comments on the alternative options identified by the Trustees and explored by the Panel. Should the Trustees decide to reject the Plan and adopt a significantly different approach, we strongly recommend that the Foundation seek additional public comment before making a final decision.

Thank you for providing us the opportunity to comment on this matter. If you have any questions or wish to discuss this letter, please feel free to contact Amy Ripepi at 312-345-9103.

Sincerely,



Financial Reporting Advisors, LLC