

## Heads Up

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## One Size Does Not Fit All

# Blue-Ribbon Panel Reports on Private-Company Accounting Standards

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### Introduction

On January 26, 2011, the Blue-Ribbon Panel (BRP) released a [report](#) that includes recommendations to the Financial Accounting Foundation (FAF), the FASB's parent organization, on how "accounting standards can best meet the needs of users of U.S. private company financial statements." The major recommendations include (1) the creation of a new private-company standards board that would focus on "making exceptions and modifications to U.S. GAAP" for private companies and (2) the creation of a differential accounting framework that would allow the FASB to make appropriate and justifiable exceptions and modifications. The BRP report does not recommend the development from scratch of a separate set of GAAP for private companies.

### Background

Formed in December 2009 by the AICPA, the FAF, and the National Association of State Boards of Accountancy, the BRP comprises (1) representatives from financial reporting constituencies, such as lenders, investors, and owners, and (2) preparers, auditors, and regulators. The BRP's purpose is to "address how accounting standards can best meet the needs of users of U.S. private company financial statements." The report containing recommendations to the FAF represents the culmination of the BRP's activities. (Note that the BRP's scope includes only for-profit entities; it does not extend to not-for-profit entities.)

### Standard-Setting Issues

The report highlights systemic issues with the current U.S. accounting standard-setting process, notably the failure to sufficiently (1) understand the needs of users of private-company financial statements and (2) weigh the cost-benefit considerations related to GAAP for use in private-company reporting. The BRP notes that these issues have caused certain accounting standards or provisions to be irrelevant for many issuers of private-company financial statements (e.g., provisions related to fair value measurement, the goodwill impairment model,<sup>1</sup> and the accounting for variable interest entities).

<sup>1</sup> The FASB recently added a project to its agenda to explore alternative approaches to the manner in which nonpublic entities are required to assess goodwill for impairment.

Because many of the “irrelevant” standards are often the most complex, private companies are left to incur significant costs for financial statement preparation and related audit and consulting fees. In addition, because private companies are often unable to comply with such complex standards, (1) an increasing number of private-company financial statements have been prepared on an “other comprehensive basis of accounting” or (2) the related audit reports contain qualified or “except for” language. The BRP therefore recommends, at a minimum, that the current accounting standard-setting system be changed to better meet the needs of users of private-company financial statements in a cost-effective manner.

## Key Recommendations

### Standard-Setting Model

After considering several standard-setting models, the BRP concluded that existing U.S. GAAP, with exceptions and modifications for private-company reporting, would best meet the needs of users of private-company financial statements. The goal of these exceptions and modifications would be to provide decision-useful information more cost-effectively and would not be limited to presentation and disclosure.

One of the most important aspects of the new model would be the creation of a differential accounting framework that a private-company standard-setting board would use to properly evaluate the need for exceptions and modifications. Because no such framework currently exists, U.S. GAAP lack a consistent set of rules defining the differences between the provisions for private companies and those for public companies. The BRP report states that this “lack of a differential framework has contributed to the current private company concerns about relevance, complexity, and costs.”

### Board Structure

The BRP believes that the creation, by the FAF, of a separate private-company accounting standards board would best complement the BRP’s recommended standard-setting model (discussed above). This board would include representatives from the private sector and would be responsible for soliciting input and feedback from private-company stakeholders. Although the new board would not have the authority to create new accounting standards (i.e., separate GAAP), it would be given the ultimate authority to determine what exceptions and modifications should be made to the Codification to better meet the needs of private-company financial statement users. The new board would work directly with the FASB on current projects and on the development of new accounting standards. The differences for private companies could be addressed either (1) directly as part of the FASB’s standard-setting process or (2) separately by the new board itself.

One potential roadblock to the formation of such a board is the need to secure a stable funding source. The FASB is currently funded by a fee assessed on public companies that was introduced as part of the Sarbanes-Oxley Act of 2002.

### Basis for Recommendations

The report states that the “sense of urgency and the support by many users for financial statement comparability” were the driving factors behind the BRP’s recommended model. The BRP believes that a U.S. GAAP model containing exceptions and modifications for private companies constitutes the best opportunity to implement change in a short time. In addition, the BRP notes that its recommended model may help prevent an unintentional move toward a separate set of GAAP for private companies, which could decrease comparability and increase complexity in the marketplace.

The BRP concluded that the current, or even a restructured, FASB would not be able to “produce the needed exceptions and modifications to GAAP for private company financial reporting.” Rather, it proposes that the establishment of a new private-company board would be “the most realistic path forward in overcoming the systemic issue related to the relevance of GAAP for private companies.”

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## Next Steps

Because the FAF will need time to adequately evaluate the recommendations in the BRP's report and possibly take steps to create a new board, the BRP recommended that the FAF and FASB continue to take certain actions to (1) provide relief to private companies in the short term and (2) help ensure a successful transition to the model and structure that the BRP recommends. The FAF has already acted on one of the report's near-term recommendations by appointing Daryl Buck, BRP member and CFO of Reasor's Holding Company, to the FASB. The BRP's report also recommends that the FASB:

- "[C]ontinue to work closely with the PCFRC<sup>2</sup> or another similar dedicated work stream,"
- "Continue to hold separate private company roundtables for major projects."
- "Incorporate private company concerns expressed at roundtables and in comment letters."
- "Consider a delay for private companies in the effective date of major new standards . . . that is longer than the now-routine one-year delay."
- "[A]rticulate 'what differentiates private companies from public companies'" to create the "differential framework for private company accounting."
- "[L]ook at the public comment process in its standard setting and consider taking steps to make it simpler to encourage responses by a broad base of stakeholders."

The FAF is expected to discuss the BRP's final report at its next meeting on February 15, 2011.

<sup>2</sup> Sponsored by the FASB, the PCFRC was formed in June 2006 and represents all nonpublic business entities regardless of size. Its members focus on how standard-setting affects day-to-day technical activities and procedures from a cost/benefit perspective. The PCFRC sets its own agenda and makes specific technical recommendations for possible modifications for private companies on existing or developing FASB standards.

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