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MP&S ACCOUNTING AND AUDITING ALERT: THE FAF SETS THE STAGE FOR PRIVATE COMPANY GAAP

On May 23, after considering numerous public comments, the Financial Accounting Foundation (FAF) — parent organization to the Financial Accounting Standards Board (FASB) — approved the creation of the Private Company Council (PCC).

The PCC will identify and vote on exceptions and modifications to US Generally Accepted Accounting Principles (GAAP) that respond to the needs of private companies and their financial statement users. Its decisions will be subject to "endorsement" by FASB. The PCC will replace the existing Private Company Financial Reporting Committee (PCFRC).

The Road to Private Company GAAP

Unlike public companies, private companies generally aren't legally obligated to follow GAAP. Nevertheless, many private companies prepare audited, GAAP-compliant financial statements to satisfy lenders, sureties, venture capitalists and other stakeholders. In some circumstances, private companies may be subject to regulators other than the Securities and Exchange Commission (SEC), who require GAAP financial statements. But preparing GAAP financial statements for private companies often results in added complexity and expense that yields little or no benefit for financial statement users.

Last year, a blue-ribbon panel sponsored by the FAF, the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy recommended that the FAF establish an autonomous board with standard-setting power to address the needs of private companies. The board would focus on making exceptions and modifications to US GAAP rather than creating a new set of standards.

In October 2011, FAF trustees voted against the panel's recommendation, proposing instead to establish a Private Company Standards Improvement Council (PCSIC). The PCSIC would identify appropriate exceptions and modifications to GAAP for private companies, subject to ratification by FASB. The FAF was concerned that establishing an independent board would lead to a "two-GAAP system."

Critics, including the AICPA, argued that the proposal didn't go far enough to remove the PCSIC from FASB control. In a statement on its website, the AICPA said that "the FAF's proposal on private company financial reporting . . . falls substantially short of what is necessary to make GAAP relevant for private companies by not including establishment of a separate authoritative board."

The PCC's Role

The FAF's new plan generally follows its October 2011 proposal, with several changes designed to address commenters' concerns. In addition to shortening the body's name from "PCSIC" to "PCC," the plan makes several changes designed to temper FASB's control and influence over the PCC. For example, the plan provides that the PCC chair will not, as originally proposed, be a FASB member.

The plan also specifies FASB's role in endorsement. Endorsement is based on a simple majority vote of FASB members. The endorsement process requires FASB to explain its decisions. It addresses the concern of some commentators that FASB has too much power by allowing it to "veto" or "table" PCC proposals.

According to the FAF, the process of setting standards for private companies will work as follows:

- The PCC and FASB will jointly establish criteria for determining when exceptions or modifications to GAAP are warranted for private companies.
- Applying these criteria, the PCC will determine which elements of GAAP to consider for exceptions or modifications. These determinations will be made by a vote of two-thirds of all sitting PCC members, in consultation with FASB and with input from stakeholders.
- Proposals endorsed by a simple majority of FASB members will be exposed for public comment.
- At the end of the comment period, the PCC will redeliberate the proposals and submit them to FASB, which will make a final endorsement decision, usually within 60 days.
- If FASB endorses a proposal, the proposal will be incorporated into GAAP. If it doesn't, the FASB chair will provide the PCC chair with a written explanation, together with suggestions for potential adjustments that might alter the result.

The PCC will consist of nine to 12 members, appointed by the FAF, including "a variety of users, preparers and practitioners with substantial experience working with private companies." Members will serve three-year terms, after which they may be reappointed for additional two-year terms.

The PCC will hold at least five meetings each year and will be overseen by a newly created Private Company Review Committee consisting of FAF trustees. The committee will monitor PCC meetings and activities and hold the PCC and FASB accountable for addressing private company issues.

The FAF will conduct an overall assessment of the PCC following the PCC's first three years of operation to determine whether its mission is being met and whether further changes to the standard-setting process for private companies are warranted.

AICPA to Develop OCBOA for Private Companies

The AICPA expressed its support of the FAF's plan, but it also says more needs to be done to address the accounting needs of small and medium-size enterprises (SMEs) and their financial statement users. To that end, the AICPA plans to launch an "other comprehensive basis of accounting" (OCBOA) financial reporting framework for SMEs.

According to AICPA President Barry Melancon, "The enhanced and simplified financial reporting framework will be a cost beneficial solution for smaller privately held entities that do not need to comply with US GAAP."