The Latest Efforts to Simplify Accounting for Small, Privately Held Companies

Arthur F. Rothberg, Managing Director, CFO Edge, LLC

For years, there has been an ongoing debate in the accounting community regarding to what degree the complex requirements of generally accepted accounting principles (or GAAP) apply to small and non-public companies. U.S. GAAP was created primarily for publically held companies that have to meet strict regulatory reporting requirements.

However, a number of privately held companies are required to follow GAAP by their credit agencies and lenders. Many of them believe that GAAP essentially amounts to accounting overkill for small, non-public companies. To address these concerns, the Financial Accounting Standards Board (FASB) created the Private Company Council (PCC) in 2012 to create private company exceptions and modifications to U.S. GAAP. These exceptions are sometimes referred to as "Little GAAP."

FASB soon issued for public comment several PCC proposals that address the relevance and complexity of certain aspects of GAAP for private companies. This past October, the PCC finalized a proposal that would make changes to GAAP to help simplify the accounting treatment for intangible assets acquired in business combinations, goodwill, variable interest-rate entities, and certain types of interest rate swaps.

Specifically, the proposal would allow private companies to amortize goodwill on a straight-line basis over 10 years at the longest. It would also limit the requirement for goodwill impairment testing to times when a triggering event indicates that the fair value of the entity is below its carrying amount. FASB is currently considering the PCC proposal, and if the proposal is endorsed by FASB, it will be issued as final Accounting Standards Updates to take effect for the period beginning after December 15, 2014.

Big GAAP vs. Little GAAP

Few in the industry question the fact that many of the requirements of GAAP are, indeed, overly complex and cumbersome for private companies. However, some are concerned about the confusion and possible deterioration in the quality of financial statements that could result if there were two separate forms of GAAP — i.e., Big GAAP and Little GAAP.

At a recent roundtable discussion on the topic, one possible compromise that was brought up is to tweak GAAP so that it is less cumbersome and easier and less costly for private companies to use, rather than create two separate GAAPs. "As far as the accounting, whether there should be Big GAAP, Little GAAP, or somewhere in between, I think there are differing points of view," stated former FASB chairman Bob Herz. Meanwhile, NYU Stern accounting professor Sy Jones wondered, "So we might not be talking about Big GAAP vs. Little GAAP, but Big GAAP vs. Many GAAP."

FRF for SMEs

While the PCC was finalizing its proposal to simplify GAAP, the American Institute of Certified Public Accountants (AICPA) was working on creating a new financial reporting framework (FRF) that gives small and medium-sized entities (or SMEs) the option of adopting a more simplified and less costly method of presenting financial statement to their stakeholders. SMEs are not required to report financial information in accordance with U.S. GAAP.

The most significant aspect of FRF for SMEs is the fact that it replaces U.S. GAAP's primarily rules-based framework with a more principals-based framework. U.S. GAAP is comprised of about 25,000 pages, while FRF for SMEs includes about 200 pages. It uses a blend of traditional income tax methods and accounting principles to present a company's financial position, cash flows and results of operations in a more simplified manner. Both preparers and users of financial statements are likely to find the new framework more useful in making sound business decisions.

With FRF for SMEs, businesses can present their financial information using the historical cost convention, instead of the fair value measurements required by U.S. GAAP, which will likely save them money. Also, FRF for SMEs does not recognize the concept of comprehensive income, which U.S. GAAP requires for certain transaction types. Therefore, operational results are recognized through the income statement. In addition, FRF for SMEs:

- Simplifies revenue recognition.
- Removes recognition requirements for derivatives, hedging activities and stock-based compensation.
- Removes reporting and disclosure requirements for variable interest entities.
- Gives SMEs the option of presenting parent company-only financial statements.
- Gives SMEs the option of presenting income taxes using either the deferred income tax method or the income taxes payable method of recognition.
- Removes the U.S. GAAP requirement that SMEs evaluate and possibly record uncertain tax positions.
- Allows goodwill to be amortized over a 15-year period.

Note that FRF for SMEs is non-authoritative, so its implementation is optional for SMEs.

Concluding Thoughts

The Private Company Council has finalized a proposal that would make changes to U.S. GAAP and could be the first step toward the creation of "Little GAAP," although not everyone in the accounting community believes that creating Little GAAP is a good idea. In addition, the AICPA has created a new financial reporting framework (FRF) that gives small and medium-sized entities (or SMEs) the option of adopting a more simplified and less costly method of presenting financial statement to their stakeholders. Both of these efforts aim to simplify accounting for small, non-public companies. An outsourced CFO services provider can help you determine how these developments might impact your company's accounting functions.

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we're passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 ext 101.