



SIMPLER FINANCIAL REPORTING FOR PRIVATE COMPANIES

Private companies soon may get relief from preparing financial statements based on Generally Accepted Accounting Principles (GAAP), which contain complicated measurements and onerous disclosures. Additionally, users of those statements may finally get just the information they need without having to comb through the statements to find what they are looking for.

Two high level efforts are underway to streamline how private companies report their financial position, results of operations, and the disclosures they make about their finances. These efforts are in response to calls for simplicity by private companies, their auditors and others who use those financial statements.

Regulators called for tougher accounting and disclosure standards because of the increased pace of business, the presence of complex transactions and several major frauds and business failures. The enhanced regulations targeted several key topics, including:

- Measuring the value of stock option grants and other transactions involving a company's equity.
- Analyzing goodwill and other long-term assets for impairments, rather than simply amortizing the costs.
- Considering the need to consolidate for companies related by common ownership even though doing so might cloud the real operating business.
- Measuring income tax expense, which may have little to do with how much a company actually pays in taxes, making it hard to reconcile financial statements with tax returns.

Since most bank loan and investor agreements call for financial statements to be prepared in accordance with GAAP, the burden of these standards fall on large and small and public and private companies alike.

And because accounting standards have largely been set in response to the needs of large, public companies and their investors, the needs of private companies and their users have taken a back seat. Standard setters at the Financial Accounting Standards Board (FASB), which sets GAAP, have not focused on private companies and their unique needs, leaving those companies to struggle with adapting to requirements that add little or no value to their financial reports. Often, the owners of those companies cannot explain to users the significance of the disclosures in their reports.

Starting in 2013, however, some big changes are on the way. After a strong push led by the American Institute of Certified Public

Accountants (AICPA), the National Association of State Boards of Accountancy (NASBA), and the Financial Accounting Foundation (FAF), the FASB agreed to reconsider private company financial accounting standards.

This could be the start to what might be called "Big GAAP" and "Little GAAP." "Big GAAP" would apply to public companies and to all other companies that would not qualify to follow more streamlined standards. "Little GAAP" will consist of a more straightforward, less complex set of standards with fewer disclosures that would be applied by private companies that pass a hurdle to demonstrate that the needs and makeup of their users qualify for streamlined reporting. Auditors would have to approve the approach being taken by each company.

While the specific standards of the FASB's plan have not been identified and the specific qualifying factors have not been determined, the approach is attractive because companies that are required to prepare GAAP -basis financial statements will be able to comply at a lower cost.

For some private companies, preparing GAAP financial statements will remain unnecessary. For those companies, the AICPA is developing an alternative Financial Reporting Framework (FRF) for small- to medium-sized entities (SMEs). This framework will be a comprehensive basis of accounting that could be used by SMEs to communicate their financial matters to third parties. The AICPA will publish its guidelines this spring.

Will the FASB's effort at "Little GAAP" for qualified preparers sufficiently streamline financial reports to meet users' needs? Will the AICPA's effort to develop a new framework of accounting for owner-managed businesses that don't need GAAP statements satisfy lenders and other users of that financial information?

It's too early to tell. However, these efforts recognize at the highest level of the accounting world that private entities are different and that GAAP is not meeting their needs. These efforts are the most significant undertakings ever in this area to address these problems. While we are more than a year or two away from final solutions, it is not too soon to begin to follow the developments as they unfold.

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