Spotlight on Private Company Accounting
Part of the Perfect Storm

“We are face to face with our destiny and we must meet it with a high and resolute courage.”

- Theodore Roosevelt

About the Author

William F. O’Brien, MBA, CPA, is a financial management consultant and educator with over 40 years experience. He has held senior financial management positions with Intel Corporation and ROLM Corporation and served as CFO for several emerging high technology companies. Mr. O’Brien has extensive experience in corporate planning, financial analysis, cash management and managerial accounting in both domestic and international settings. He is on the faculties of Santa Clara University and San Jose State University and is a former speaker of the year for the California CPA Education Foundation.
Elements of the Storm

- IFRS adoption, including IFRS for SMEs
- Convergence completion
- Private company GAAP implementation
- NFP Advisory Committee (NAC) Recommendations

Private Company Reporting

- Unique reporting standards for non-public companies
- Full U.S. GAAP and IFRS viewed too complex for smaller companies
Private Companies are Not Small Business

• 2010 Forbes.com study found:
  – Top 100 private companies’ revenue ranged from $3.6 to $109.8 billion
• Financial transactions may be no less complex than public companies

Reporting Options for SMEs

• U.S. GAAP
• IFRS for SMEs
• IFRS
• Private Company GAAP (PCC)
• AICPA OCBOA (FRF)
IFRS for SMEs

• Issued in July 2009 to enthusiastic reception in U.S.
  – 230 pages; 35 sections; generally stand-alone
  – Revisions once every 5 years, initial review in 2012
  – Multiple languages
  – Organized by topic, similar to ASC
• Immediately approved for U.S. private entities
  – No public accountability; general purpose financial statements
• Later rejected in favor of unique private company reporting model

Current Acceptance of IFRS for SMEs

• Acceptable OCBOA for entities that lack “public accountability”
  – No public equity or debt; does not hold fiduciary assets
• Each state board of accountancy has to approve acceptability
• Benefits of IFRS for SMEs
  – Improved access to capital validated by scholarly research
  – Improved comparability
  – Lower cost of compliance
  – Stable platform for 4-5 years; 2014 effective date of 1st review
• Substantial training assistance
• Over 70 jurisdictions have adopted IFRS for SMEs
How SME is Simplified

• Irrelevant topics omitted
• Fewer options
• Simplified measurement
• Reduced disclosures
  – 400 vs. 3000 in full IFRS

Potential SME Benefits

• Academic research
  – Lower cost of capital
  – Lower cost of implementation
  – Improved accessibility to capital
• Improved comparability
• Standards stabilization
  – Updates every 4-5 years
SME versus GAAP

• No extraordinary items
• Exceptions based on “practicability”
• No FV option
• No LIFO
• LCM: ceiling only
• Reversal of inventory write-downs
• Joint venture and investment property provisions

SME versus GAAP (cont’d)

• Componentization required
• No interest capitalization
• Goodwill amortization
• Contingencies recorded when “more likely than not”
• Contingent cash flows are discounted
• Deferred tax assets must be probable
• Detailed transition procedures
U.S. Private Company Financial Reporting

- Chaired by Rick Anderson, CEO Moss Adams LLP
- Major events:
  - Recommendations sent to FAF
  - FAF decision in May 2012

Blue Ribbon Panel Recommendations to FAF

- Released in 2/11
- 5 member standard-setting board reporting to FAF
- Exceptions and modifications to GAAP
  - “Carve-out” considered a more realistic option
- Focus on lenders and other users of private company financial reports
- 3-5 year sunset review of the process
Private Company Council

• Billy Atkinson, former NASBA chair and PWC partner, named chairman
• 10 person council
• Decision-making framework proposed
• Initial meeting 12/6/12 webcast live
  – Current deliberations:
    – Interest rate swaps
    – VIEs
    – FIN 48
    – Acquired intangibles

AICPA on PCC

• PCC more independent than originally proposed
• Emphasis on collaboration versus control
• FASB will endorse PCC recommendations rather than ratify
• Non-FASB chairman
• Fewer members than proposed
• 5 meetings per year
• 3 year review
FRF-SME Exposure Draft

AICPA Financial Reporting Framework (FRF)

- Proposed in May 2012
- Initial exposure draft Fall 2012
  - Exposure period ended 1/31/13
  - May be re-exposed
- Comments not universally positive
  - NASBA and PWC asked AICPA to reconsider
- 32 Sections; more complex than anticipated
- Implementation guidance to follow
- Geared to bank usage
**FRF Overview**

- Reduces GAAP to 252 pages
- Based on traditional accrual and income tax accounting
- Less complicated; less costly
- Principles based...requires judgment
- Less disclosure
- For F/S not requiring GAAP

**FRF Structure**

- Organized by topics
- 32 Chapters across a variety of elements
- Formulated by SME-based Taskforce
- Updates every 3-4 years
- No effective date...IT’S OPTIONAL!
FRF versus GAAP

- No extraordinary items
- Lower of cost or NRV versus market
- No comprehensive income
- Goodwill amortization
- Traditional lease accounting
- No VIE consolidation
- No Mark-to-Market for certain financial instruments
- Push down accounting permitted

Private Company Financial Reporting Options and Actions
Issues to Consider When Choosing

- GAAP and Systems migrations
  - Minimize disruption
- Strategic directions
  - IPO or other “public event”
- Reporting structure
  - Foreign parent
  - Stakeholders
- Educational considerations
  - Academics, users and preparers
  - Practitioners

What Comes Next?

- Establishment of the Private Company Council
  - Details need to be provided
- AICPA proposal of a “non-GAAP” OCBOA
  - Details also needed
- Further constituent input and, ultimately, exposure for comment
- Your involvement!
Business Issues Surrounding Private Company Reporting Options

“Solve it. Solve it quickly, solve it right or wrong.”
- Thomas Watson

Private Company Reporting Business Issues

- Systems implications
- Tax implications
- Customer-vendor implications
- Lender implications
- Profitability implications

- Time commitments
- Professional services
- Governance implications
- Staffing implications
- Procrastination
1. Systems Implications

- All systems will change
- Minimize multiple implementations
- Usual IT implementation effort
  - Integration and implementation will be time consuming, distracting and costly
  - Software, hardware, documentation and training

2. Tax Implications

- LIFO impact of IFRS for SMEs
  - IRS congruence will be needed
- Other GAAP changes may impact taxable income as well
  - Reserves
  - Lease accounting
  - Revenue recognition
3. Customer-Vendor Implications

- Broad education effort
- May create business opportunities for companies
- May make procurement more efficient
- Practice development opportunity for small CPA firms

4. Lender Implications

- No surprises
- Early involvement is critical
- Avoid being an alarmist
- Always consider “Plan B”
5. Profitability Implications

- Changes in form and content could alter the bottom-line
- Financial reporting changes will cost $
  - Understand the cost-benefit implications
- Profit sharing and other incentive compensation calculations could change
  - EBITDA and NOI implications

6. Time Commitment Implications

- Implementing these processes are time consuming
- Cannot lose focus on running the business
- All functions within the operations could be affected
7. Professional Services Implications

- Current capabilities of tax and assurance professionals
- Significant reliability on consultants could be costly and result in loss of intellectual property

8. Governance Implications

- Failure to address these issues is a major risk for small businesses
- Lower cost of capital implications
- Opportunities for additional sources of capital
9. Staffing Implications

- Determination that the right people are in the right places
- All employees, management and directors must champion these causes

10. Procrastination Implications

- People are slow to embrace change
- Delays increase the pressure to perform
  - Tendency to use consultants
- There is NEVER time to do things right initially, but ALWAYS time to correct them!
Action Items for Consideration

**TODAY!**

“We become just by performing just action, temperate by performing temperate actions, brave by performing brave action.”

- Aristotle

Remember: Procrastination is *Not* an Option!

- The issues at hand are critical
  - Similar to RFS and full IFRS issues
- Consider these 10 Action Items for Today
  - Or create your own!!!
A Recipe for Success
(These may seem obvious, but often its the obvious that we overlook!)

• Do your Financial Reporting homework-stay current
• Balance accounting basis with strategy
• Include your CPA in the discussions
• Get your banker involved
• Study the competition
• Develop a pro-forma model
• Maintain senior management and board involvement
• Remember the change process
• Communicate the end result
• Remember you have options!

Do Your PCFR Homework: Stay Current

• Routinely check the AICPA website
• Rotate update responsibility among your staff
• Look for early adoptees and draw on their experiences
Balance Accounting with Strategy

- Clearly understand the strategic direction of your company
- Pay close attention to any events that would move you out of private company status
- The goal is to avoid multiple conversions

Include Your CPA in the Discussions

- Ensure that your outside accountants are on the same page with your interpretation of PCFR
- PCFR is NOT as basic and simple as advertised; avoid reporting surprises
Get Your Banker Involved

- Ultimately your banker will “decide” which basis of accounting you will follow
- Get your lenders involved early conversations

Study the Competition

- Identify what “best practices” are being followed in your industry
- Use the AICPA FAQs for FRF implementation
Develop a Pro-forma PCFR Model

- While in the “exploration” stage, convert your current financial statements to a pro-forma PCFR model
- Review this information with CPAs and bankers

Maintain Senior Management and Board Involvement

- Inform the senior management team rather than alarm
- Neither over-react nor procrastinate
Remember the Change Process

- Human nature will resist most attempts at change
- Understand the emotional impact that a change in F/S format can elicit
- Keep focus on the end objective

Communicate the End Result

- The overall goal is simplified reporting...that meets the needs of the financial statement users
- Do not lose focus on this goal
- Alert your company with respect to on-going progress
Remember, You Have Options!

- Make your choice carefully
- Consider what is best for all of your stakeholders including yourself!

Four on the Floor

YOUR TAKE AWAY
Things to Remember

My Four on the Floor

1. Be an agent of change
2. Take ownership in your profession
3. Make this a business process transformation
4. Take action **NOW!**

Opportunity is at your doorstep...

*Invite it in!!!*
Who Was That Guy?

Bill O’Brien
E:mail: wfocpa@aol.com
Phone: (408) 499-3999