The Private Company Financial Reporting Committee: A New Voice In FASB's Process

By: **Kennard S. Brackney** and David R. Mautz

Abstract

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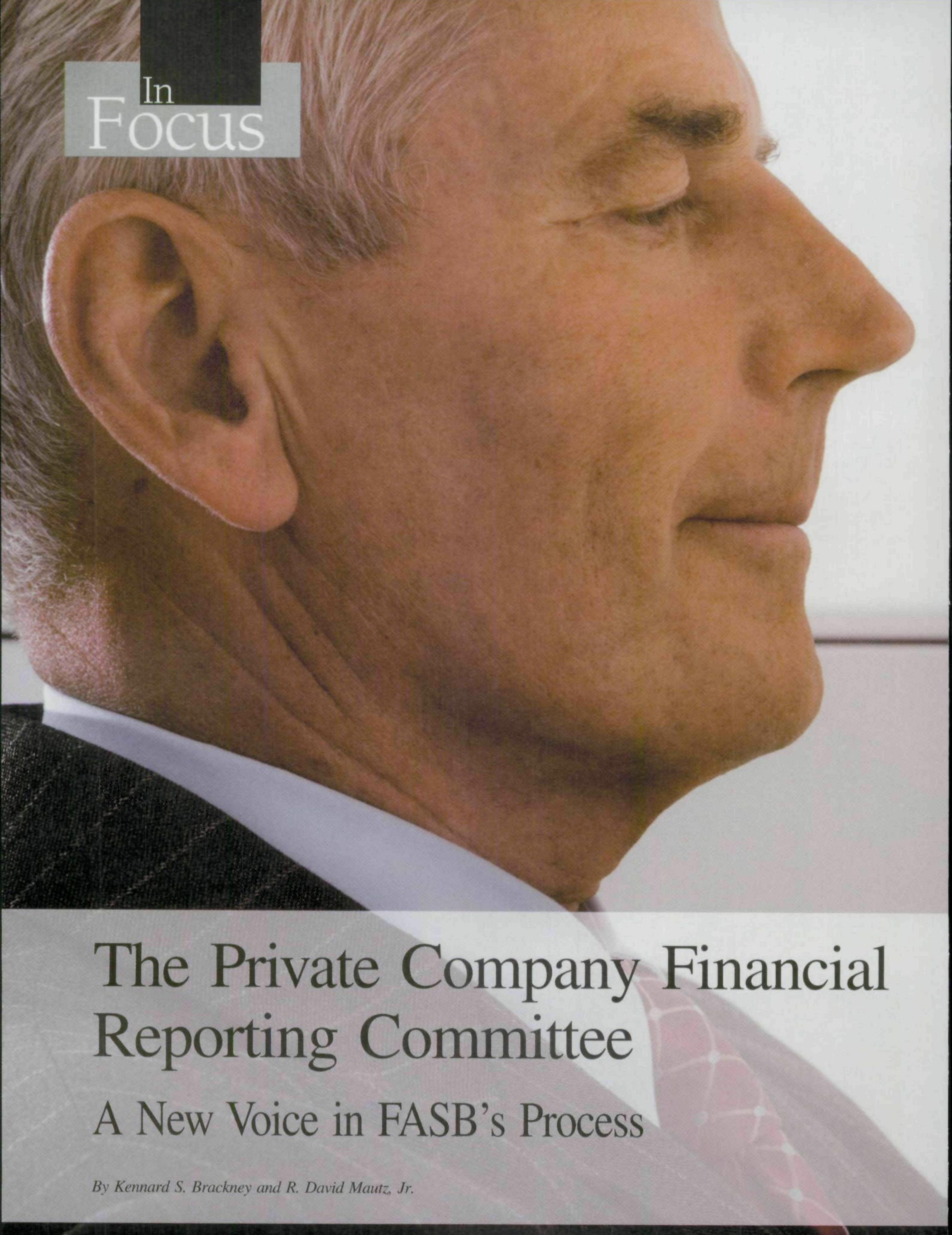
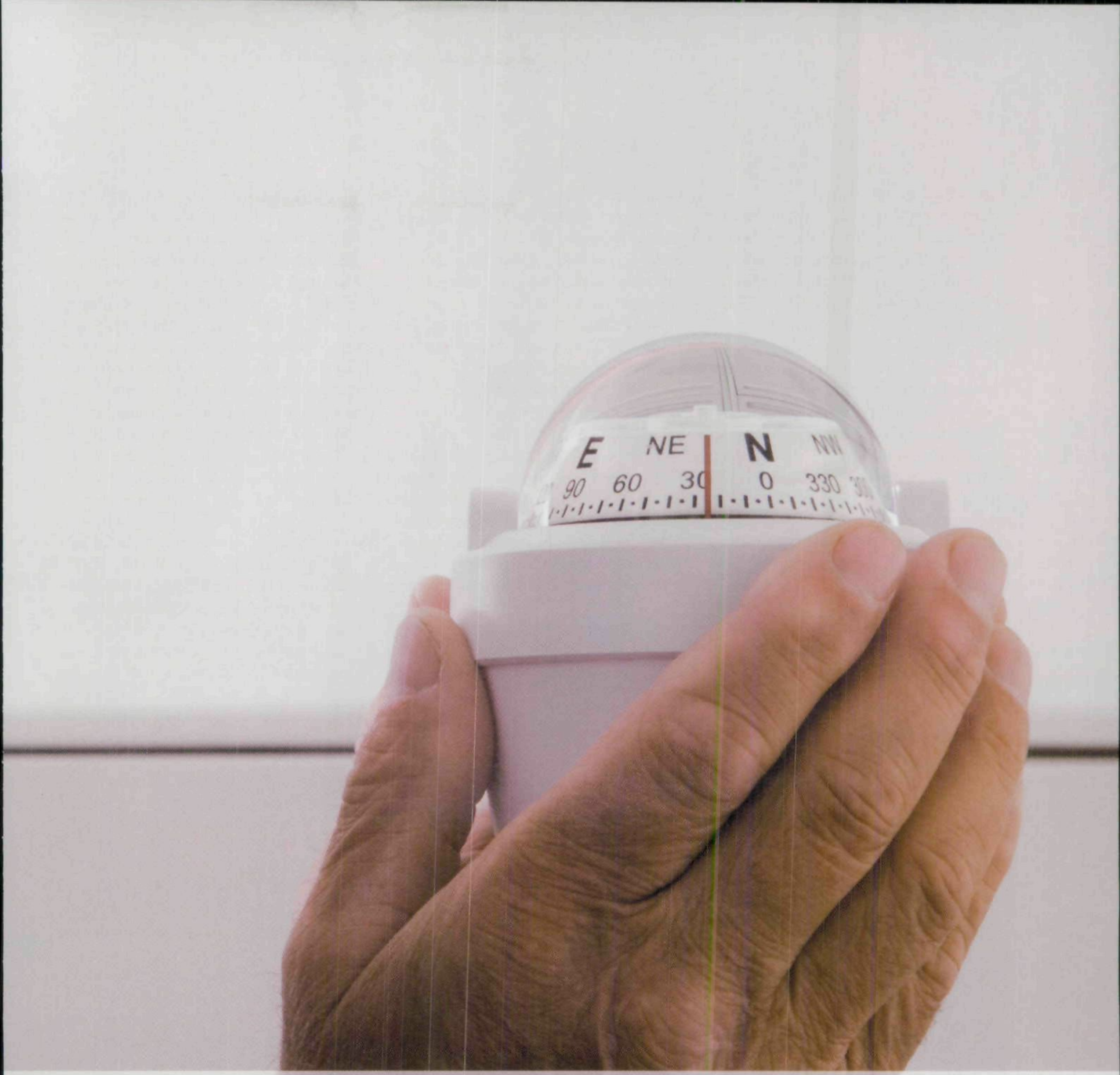


The Private Company Financial Reporting Committee

A New Voice in FASB's Process

By Kennard S. Brackney and R. David Mautz, Jr.



The Private Company Financial Reporting Committee (PCFRC) began its work as an official part of FASB's standards-setting process in January 2007. The PCFRC's role is to provide systematic input on proposed and existing standards from a private company perspective. The formation of the PCFRC is, arguably, the most significant development to date in the long-running debate about private company reporting in the United States.

Opinions are divided about the need for separate private company reporting standards. Opponents of separate standards, such as Barry Jay Epstein (see "Information Overload Can Threaten Sound Decision-Making," *The CPA Journal*, March 2007) argue that amending GAAP for private companies is unnecessary and potentially harmful to these companies and the CPAs who serve them. Many interested parties, instead, view the creation of the PCFRC as an opportunity to improve the relevance of GAAP to private companies, tailor financial reporting to the needs of stakeholders, and reduce the burden of complex standards.

The PCFRC and Its Role

The PCFRC is jointly sponsored by FASB and the AICPA. The two bodies announced the committee's formation and the naming of its first chair (Judith H. O'Dell) in December 2006. The PCFRC's mission is:

> To consider differences in prospective and existing GAAP accounting standards related to private companies based on user needs and cost/benefit considerations, and make formal recommendations to the Financial Accounting Standards Board.

The committee consists of the chair—whose position is part-time and paid—and 12 volunteer members appointed to one-year terms. Committee members may be reappointed for up to three consecutive years. Membership is structured to include four financial statements users, four preparers or owners, and four CPA practitioners. The user group includes two lenders, one private-equity investor, and one representative of the surety industry.

The PCFRC's first meeting was May 10–11, 2007, in Chicago. It plans four to six meetings per year at locations to be determined by the chair. Its 2008 schedule has included meetings in New York (January), San Diego (April), and Atlanta (June), and will conclude with meetings in Boston (September 18–19) and New Orleans (November 13–14). The committee also works via conference call, as needed.

Meetings are open to the public, and audience members may address the committee during an open town-hall portion. The PCFRC website, www.pcfr.org, includes a registration page for parties planning to attend a meeting, meeting schedules, agendas, summaries of prior meetings, and other committee documents. The PCFRC has also established a mechanism to interact with its constituents: Interested parties may join the committee's Resource Group by registering at the website. Resource Group members receive information and materials by e-mail and may be invited to provide input to the committee.

The PCFRC has identified three objectives. First, its members will serve as resources to FASB's standards-setting operations. The committee outline describes these interactions as "informal, confidential input" to FASB staff. Second, the PCFRC will issue formal recommendations to FASB regarding prospective new standards. The committee will identify projects of particular interest to private company constituents, will meet to discuss and deliberate issues, and will make formal recommendations to FASB. Third, the committee will evaluate existing GAAP to identify standards that need to be modified for private companies. All formal recommendations come from the committee as a whole and require a two-thirds majority vote.

EXHIBIT 1
IASB's Proposed Recognition and Measurement Simplifications for SMEs

IASB Standard	Issue	Proposed Simplifications
IAS 39	Financial instruments	Report most investments at fair value, with changes in fair value included in net income; report qualifying investments at cost or amortized cost; and use a simplified form of effectiveness testing for hedges.
IFRS 3	Goodwill impairment	Test goodwill for impairment only when an indicator of impairment is present.
IAS 38	Research and development costs	Expense all research and development costs as incurred.
IASs 28 and 31	Associates and joint ventures	Use either the cost method or the fair-value method, with changes in fair value included in net income.
IAS 12	Income taxes	Recognize deferred income taxes based on timing differences.
IAS 41	Agricultural activities	May use the cost-depreciation-impairment model, where fair values of biological assets are not readily determinable.
IAS 19	Defined-benefit plans	Immediately recognize actuarial gains and losses in net income.
IFRS 2	Share-based payments	SMEs unable to determine the fair value of equity instruments granted may continue to apply the intrinsic-value method.
IAS 17	Leases	Lessees in a capital lease should initially recognize assets and liabilities at their fair values.
IFRS 1	Transition to IFRS	SMEs unable to provide restated information based on full IFRS for the comparative year may omit this information.

Earlier Studies on Private Companies

FASB formulates GAAP for all businesses, public and private, and employs an open process designed to elicit and incorporate input from constituents. Public companies and large public accounting firms have participated actively, arguably becoming the dominant voices in this process. The AICPA, through its Private Companies Practice Section (PCPS, pcps.aicpa.org), often considers the needs of private companies and their statement users, and whether FASB's open process is serving those needs. Prior to issuing the PCFR Task Force Report in 2005, the AICPA conducted or sponsored other studies of private companies and their statement users (e.g., 1976, 1980, 1983, and 1996).

The AICPA studies produced a fairly consistent set of recommendations for standards-setting bodies. Three relate to FASB, and the fourth to the AICPA. First, FASB should simplify complex requirements in GAAP for the benefit of all companies. The board should pay particular attention to reducing the complexity of disclosure requirements. Second, FASB should maintain a "single GAAP" approach for all companies, but provide more modifications and exceptions for small or private companies. Third, FASB should improve the representation of small or private companies in its standards-setting process. Finally, the AICPA should provide clear guidance for small or private companies that present financial statements on bases other than GAAP (e.g., cash basis, income tax basis).

FASB sponsored a major study of the needs of private company financial statement users in the early 1980s. The report, *Financial Reporting by Private Companies: Analysis and Diagnosis*, revealed a division of opinion regarding satisfaction with the existing model, whereby private companies apply the same version of GAAP as public companies. A majority of both the public accounting practitioners and private company managers participating in the study agreed with the propositions that a separate set of GAAP, targeted at private companies, would enhance the usefulness of financial statements and would reduce compliance costs. In contrast, the commercial bankers participating in the study were nearly unanimous in their expression of satisfaction with private companies using existing GAAP (i.e., a single GAAP serving both public and private companies). These AICPA and FASB studies have played a major role in shaping the development of current U.S. standards and practices.

Current U.S. Practice

Private companies in the United States are not required to issue financial statements. The PCFR Task Force Report of 2005 reveals that approximately 30% of private companies release no financial statements to external users. U.S. private companies that choose to issue financial statements have three alternatives: 1) apply GAAP in full; 2) report under GAAP, but depart from one or more requirements; or 3) adopt an "other comprehensive basis of accounting" (OCBOA). In other words, U.S. private companies are free to assess the costs and benefits and to choose the reporting alternative that best satisfies their users' needs.

Reporting alternatives. Private-company stakeholders have expressed dissatisfaction with both the current reporting alternatives and the limited role in standards-setting that FASB's process affords them. Many private companies that issue financial statements choose to apply GAAP in full. Over time, FASB has embedded modifications and exceptions for small or private companies into its standards. A search of the Financial Accounting Research System infobase (www.fasb.org/fars/index.shtml#infobases) finds a total of 35 such modifications or exceptions. Most of them explicitly target private companies. Of the 35 differences, 25 relate to pronouncements that remain in effect. Analysis of these 25 reveals that the most common difference is a delay in the effective date (eight cases), followed closely by an exemption from disclosure requirements (seven cases). In five cases, GAAP allows private companies to use simpler measurements.

Two cases in which FASB has simplified measurements for private companies concern mandatorily redeemable financial instruments and share-based payments. SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, and FASB Staff Position (FSP) 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150*, together permit private companies to continue presenting most mandatorily redeemable financial instruments as equity items, measured at historical issue proceeds. Absent a public market for their shares, many private companies issue these instruments as the primary (or sole) form of equity. SFAS 123(R), *Share-Based Payment*, provides relief to private companies in measuring the cost of share-based payments. These simplifications suggest that FASB may be more open than in the past to differences in presentation, measurement, and recognition.

The second reporting alternative for private companies is to apply GAAP, but depart from one or a few specific requirements. Studies indicate that many private companies view GAAP (or certain aspects of it) as overly complex, costly to implement, and of limited value to external users. Some companies respond by applying GAAP requirements selectively. Common departures include not recognizing deferred income taxes, not accruing employee benefit costs, and not consolidating variable-interest entities (VIE). Reporting with departures is a legitimate alternative for private companies, provided their external users are willing to rely on statements that omit selected GAAP requirements.

According to the PCFR Task Force Report, as many as 15% of the private companies that prepare statements for external users have chosen this alternative at some point. Few view it as the ultimate solution for private company reporting, however, because GAAP departures have the potential to confuse financial statement readers and dilute the perceived quality of GAAP.

The third reporting alternative is OCBOA, which the AICPA formally established in 1976 to serve the needs of private companies whose external financial statement users do not demand GAAP-basis statements. These external users often rely more on first-hand knowledge of the business, or personal guarantees from the owners, than on conventional financial statement analysis. The recognized bases of accounting under OCBOA include the cash, modified cash, and income tax bases. Surveys such as the PCFR Task Force Report show that, although some companies use OCBOA and some external users accept it, OCBOA is viewed as a second-class reporting model for companies with significant external users.

Small business perspective. FASB formed the Small Business Advisory Group in 1984 to generate input from a small business perspective. The group's impact appears to have been limited. Only two pronouncements (SFASs 79 and 95) make any reference to it, and these simply state that the board consulted with the group. In 2004, FASB created the Small Business Advisory Committee (SBAC), again to offer input on standards-setting projects from a small-business perspective. The SBAC meets twice per year.

SOX and the Changing Role of the AICPA

The Sarbanes Oxley Act of 2002 (SOX) focuses on public companies and provides reason for FASB to do the same. SOX requires public companies to fund FASB's activities. "Taxing" public companies to support FASB can only increase those companies' expectations for the board to address issues that affect public companies. In addition, SOX requires FASB to pursue convergence of U.S. GAAP with International Financial Reporting Standards (IFRS), which, by its nature, targets public companies wishing to access capital in foreign markets.

SOX has impacted the AICPA as well. SOX created the Public Company Accounting Oversight Board (PCAOB), which has displaced the AICPA as the official issuer of standards for audits of public companies. Whether by design or coincidence, the AICPA has renewed its focus on private companies and has undertaken yet another study of preparers' and users' needs for financial reporting information.

This study included a comprehensive survey of three major groups: external users (lenders, investors, and sureties), insiders (owners and managers), and CPA practitioners. The resulting PCFR Task Force Report, issued in 2005, confirmed that all three groups support GAAP, albeit with concerns about specific requirements. External users identified several GAAP requirements as having medium to low relevance to private companies: pensions, VIEs, share-based payments, and intangible assets. CPA practitioners identified several GAAP requirements as being a medium to high challenge for private companies to apply: VIEs, fair value basis, share-based payments, pensions, and deferred income taxes.

It is worth noting that, unlike earlier studies, majorities of all three constituent groups in the PCFR Task Force Report expressed support for developing a separate GAAP to serve private companies. Fifty-one percent of lender respondents favored developing a separate GAAP. In contrast, only 9% of the lender respondents to the FASB-sponsored 1983 survey indicated dissatisfaction with the application of the existing single GAAP to private companies.

EXHIBIT 2
PCFRC Issues Identified in Meeting Summaries

Issue	Addressed in Recommendation Letters
Input to FASB Initiatives	
Liabilities and Equity	
Financial Statement Presentation	✓
Leases	
Subsequent Events	✓
Derivative Financial Instruments and Hedging—SFAS 133	
Business Combinations	
Revenue Recognition	
Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements —Proposed Staff Position 154-a	✓
Definition of a Private Company	✓
Concept of a Reporting Entity	
Accounting for Contingencies—SFAS 5	
FASB Codification Project	
Collaborative Arrangements—EITF 07-01	
FASB Standards Release Process	✓
Input on Initiatives of Other Standards-Setting Bodies	
International Convergence (SEC project)	✓
Small and Medium-sized Entities (IASB project)	
Initiatives of the PCFRC	
Accounting for Uncertainty in Income Taxes—FIN 48	✓(two letters)
Consolidation of VIEs—FIN 46(R)	
Share-Based Payment—SFAS 123(R)	

The PCFR Task Force Report reached the following conclusions:

- The existing reporting alternatives for private companies are not meeting external users' needs;
- A separate GAAP is required to properly serve these needs;
- FASB's process requires substantive changes to better capture the views of private companies and their statement users; and
- The AICPA should work with FASB and its oversight body, the Financial Accounting Foundation (FAF), to address these issues.

After releasing this report, the AICPA began working with FASB to design process changes consistent with the task force's conclusions. In June 2006, they issued a joint invitation to comment that recommended the creation of a jointly sponsored private company reporting committee. The proposal diverged from the task force recommendations on one important point: the issue of creating a separate GAAP for private companies. The joint proposal clearly stated that a single GAAP will be maintained for all companies, with the potential for new modifications and exceptions as the need is demonstrated. The proposal also explicitly acknowledged FASB as the source of authoritative financial reporting standards in the United States.

The proposal generated 158 comment letters. The vast majority expressed strong support for the proposed process changes, and many suggested specific standards that the new committee should consider for review. The standards mentioned most frequently pertained to VIEs, share-based payments, and mandatorily redeemable financial instruments. Given the favorable response, the two bodies moved to establish the PCFRC in late 2006.

International Developments

Efforts to address the reporting needs of small or private companies have moved more rapidly outside the United States. Leading examples are the United Kingdom, Canada, and the International Accounting Standards Board (IASB), with its Small and Medium-sized Entities (SME) project. Each has the potential to provide valuable lessons, both positive and negative, to U.S. standards setters.

United Kingdom. The United Kingdom initiated a differential reporting system in 1997 in the form of the Financial Reporting Standard for Smaller Entities (FRSSE), which applies to private companies falling below specified thresholds in sales, assets, and employees. FRSSE is a stand-alone set of standards for these companies, and is organized in an easy-to-use format. It mainly provides disclosure relief, although it also exempts qualifying companies from presenting a statement of cash flows, recognizing equity-settled share-based payments, or applying the temporary difference approach to income taxes. With the European Union monitoring the IASB's SME project, the role of FRSSE in the United Kingdom could change soon.

Canada. Canada implemented a differential reporting system in 2002. The country's Accounting Standards Board (AcSB) is authorized to establish simplified reporting options for companies that have no public accountability. Private companies elect these options issue by issue, and each election requires unanimous consent from owners. To date, the AcSB has approved eight elective options, several of which relate to recognition and measurement. With Canada's decision to require public companies to convert to IFRS in 2011, the AcSB is reviewing its strategy with respect to developing standards for private companies. Canada is monitoring the SME project with considerable interest.

IASB's proposed SME standards. The IASB issued a preliminary views document in 2004, proposing the development of a separate, simplified version of IFRS for private companies. More than 100 countries now permit or require the use of IFRS. Developing countries that have adopted IFRS for public company reporting often also require that private companies use them. This approach can lead to problems, however, because IFRS mainly serves public companies that are seeking capital in foreign markets.

The IASB received a strongly supportive response to its proposal, and in February 2007 it issued draft standards, "Proposed IFRS for Small and Medium-sized Entities." The proposed SME standards are based upon the same conceptual framework as full IFRS, but they offer private companies advantages in terms of length, organization, and the requirements themselves. At 320 pages, the proposed SME standards are less than 15% of the full IFRS. Similar to FRSSE, the proposed SME standards have a simple, straightforward structure, organized by financial statement and the specific items within each. The proposed SME standards provide numerous modifications and exceptions, most dealing with disclosure and presentation issues. In addition, they include 10 simplifications of recognition and measurement requirements (see *Exhibit 1*).

The proposed SME standards target companies with 50 or fewer employees and significant external users. Of course, individual jurisdictions will have the final say on whether these standards can be used, and by whom. The exposure draft prohibits public companies from using SME standards and claiming compliance with them. The comment period ended October 1, 2007, and the IASB is reviewing and discussing the feedback received. For updates, refer to the IASB website (www.iasb.org).

The PCFRC will likely continue to monitor and evaluate these important developments occurring outside the United States. At the committee's first meeting, a representative from the Canadian Institute of Chartered Accountants (CICA) gave a briefing on the developments taking place in Canada. In addition, the PCFRC has formed a task force to study the IASB's SME proposal and identify any aspects that might work well in the United States.

The PCFRC's Initial Progress

At its first meeting, in May 2007, the PCFRC decided that its approach to considering prospective and existing GAAP will be to focus initially on user needs. Members representing the lending, private equity, and surety industries shared their thoughts on user needs. The meeting highlights mention that implementation costs will also be considered when the analysis of user needs fails to provide clear direction.

At its first meeting, the PCFRC also selected 11 issues to form its initial agenda. It has since added eight more. *Exhibit 2* lists these issues, organized according to the driver of the committee's decision to add the issue to its agenda (e.g., input to a FASB initiative, input on an initiative of another standards-setting body, or an initiative of the PCFRC). Although most of the 19 issues stem from current FASB projects, the committee has also identified three existing standards that it wants to review: FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes*; FIN 46(R), *Consolidation of Variable Interest Entities*; and SFAS 123(R), *Share-Based Payment*.

For some issues, the committee has formed task forces or working groups to assist with determining the need for committee input and the nature of any formal recommendations. For others, the committee has simply agreed that certain members will monitor the issue for new developments. Although the PCFRC plans to reach out informally to constituent groups, it has acknowledged that time pressures will preclude major research efforts on many topics.

The PCFRC has been very active thus far, generating eight recommendation letters in less than a year. *Exhibit 3* shows the topic of each letter, along with the publication date and any action by FASB in response to the committee's input.

Of the eight recommendation letters, five target a specific standard or standards-setting project. The first letter, issued May 16,

EXHIBIT 3
PCFRC Recommendation Letters Issued

Topic/Issue	Date	Issue Status (adapted from PCFRC website)
FASB Project on Subsequent Events	May 16, 2007	FASB tentatively accepted recommendations (1) to require that private companies disclose a financial statement cutoff date and (2) not to converge with international standards on refinancing short-term obligations and curing covenant breaches.
Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements (Proposed Staff Position 154-a)	June 10, 2007	Project dropped from FASB agenda.
Accounting for Uncertainty in Income Taxes (FIN 48)	Sept. 24, 2007	FASB proposed Staff Position FIN 48-b, delaying the effective date for certain nonpublic enterprises to fiscal years beginning after Dec. 15, 2007.
SEC Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with IFRS	Sept. 28, 2007	PCFRC input acknowledged in FAF's response to the SEC's concept release.
Effective Date of FIN 48 for Nonpublic Enterprises (Proposed Staff Position FIN 48-b)	Jan. 17, 2008	FASB issued Staff Position FIN 48-2 on Feb. 1, 2008.
Definition of a Private Company	Feb. 1, 2008	FASB considering PCFRC recommendation to define private companies in terms of "issuer/nonissuer" status.
Improvements to FASB's Standards Release Process	Feb. 1, 2008	FASB considering PCFRC recommendations to structure standard release and effective dates to facilitate private company adoption.
Financial Statement Presentation (Joint FASB–IASB Project)	Feb. 8, 2008	FASB considering PCFRC concerns about private company representation, project focus, and cost/benefit issues.

2007, relates to FASB's "Subsequent Events" project, the objective of which is to codify in GAAP the reporting requirements for events that occur subsequent to the balance sheet date, but prior to the issuance of financial statements. The PCFRC's letter asserts that the concept of an "issuance date" is not relevant to private companies because they often possess complete, audited financial statements that will be distributed at different times to different users. The committee recommended that private companies be required to disclose a specific date on which management concluded its efforts to analyze and disclose subsequent events. Based on this input, FASB has tentatively decided to add a requirement for private companies to disclose their cutoff date for reviewing subsequent events in the accounting policies note.

Two recommendation letters relate to FIN 48. The first, dated September 24, 2007, asked FASB to defer the effective date of the new standard for private companies. This letter also requested guidance on applying FIN 48 to pass-through entities, a business form common among private companies. FASB released a draft staff position in November 2007, proposing to delay the effective date for private companies to fiscal years beginning after December 15, 2007. The PCFRC sent the board a second letter, dated January 17, 2008, urging FASB to proceed quickly with finalizing the staff position, which it did two weeks later.

A letter from the committee dated February 1, 2008, responded to FASB's request for input on the proper definition of the term "private company." The PCFRC recommended defining this term via reference to the set of companies that do not meet the definition of "issuer" given in the U.S. Code. The committee favors the term "nonissuer" over the IASB's "small and medium-sized entities" and FASB's "nonpublic entities." FASB is considering the committee's view on this matter.

The PCFRC's letter dated February 8, 2008, addresses the joint FASB–IASB project on financial statement presentation. The letter conveys three points: 1) the Joint International Group formed to assist with this project does not include adequate representation from private companies; 2) this group does not include enough lenders and sureties, which are key users of private company financial statements; and 3) FASB has not provided sufficient evidence to demonstrate the deficiencies of the current reporting model, or the merits of the proposed one, from a private company point of view. The letter also offers a recommendation that FASB add a question to the "Preliminary Views" document it is drafting to seek input on the possibility of private companies being exempted from the scope of this project. The board is evaluating the committee's recommendation.

The other letters the PCFRC has issued thus far address broader aspects of standards setting, including the nature, issuance, and form of U.S. GAAP applicable to private companies. As part of its letter dated June 10, 2007, on proposed FSP 154-a, "Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements," the PCFRC objected to incorporating SEC guidance into FASB standards by reference, recommending that, if the board must rely on SEC documents, then the language of those documents should be reproduced in the FASB pronouncement. The committee added a general caution against allowing public company regulation to drive a standards-setting process that serves both public and private companies.

In its September 28, 2007, letter to FASB, regarding the SEC concepts release on the possibility of U.S. public companies being given an option to use IFRS, the PCFRC expressed support for standards convergence. It ventured beyond the focus of the concepts release, however, to ask FASB to consider developing a U.S. version of the IASB's SME proposal.

Finally, in a letter to FASB dated February 1, 2008, the PCFRC volunteered advice on FASB's standards release process, recommending changes it believes would benefit private companies and their constituents. The committee recommended that the board establish an official release period each year to standardize the timing of issuance of pronouncements and their effective dates. The committee also asked the board to consider granting private companies an automatic deferral (e.g., 12 months) of the effective date. FASB has yet to offer formal comments on any of the committee's broader recommendations.

In summary, the PCFRC has set an ambitious agenda. The committee has addressed issues with short timeframes and is beginning to investigate longer-term issues. FASB's decisions to incorporate the views of the PCFRC on subsequent events and income tax uncertainties illustrate the board's commitment to considering the private company perspective in its deliberations. Nonetheless, important questions remain as to the PCFRC's ability to achieve its ultimate objective of shaping GAAP to better serve the needs of private company constituents.

Open Questions

The potential significance of the PCFRC to private company constituents is clear. At the same time, there remain many uncertainties with regard to the financial reporting of private companies. In the authors' opinion, there are four major issues with the potential to shape private company GAAP going forward.

FASB's decisions to incorporate the views of the PCFRC on subsequent events and income tax uncertainties illustrate the board's commitment to considering the private company perspective in its deliberations.

Responsibilities and resources. The PCFRC's mission is complex and potentially expansive. Perhaps its most important challenge will be serving the dual objectives of relieving private companies from onerous GAAP requirements, while maintaining the primacy of users' needs for financial information. Making GAAP more relevant to private company stakeholders will enhance the perceived value and legitimacy of the PCFRC with financial statement users. However, alleviating the burden of complex standards is a key deliverable for private companies and their independent CPAs. The committee has chosen wisely to prioritize users' needs. To achieve its objectives, the PCFRC must avoid being perceived as merely another lobbying group seeking relief from unpopular aspects of GAAP.

Another challenge stems from the fact that even though it is an official participant in FASB's process, the PCFRC operates without the benefit of the board's substantial infrastructure. Committee members are volunteers. The AICPA and FASB provide support, but the details are unclear in the PCFRC outline. The key question is whether the ambitious agenda set at its initial meetings will prove too onerous for a volunteer committee without dedicated staff support.

Finally, interested parties should be aware that the PCFRC operations are likely to be far less formal than the extensive due-process requirements that guide FASB. The advantage of a less-formal process is evident in the speed with which the committee has been able to identify issues and generate responses. The potential drawback is that constituents may raise questions about how the committee selects the topics it chooses to address and how it arrives at its recommendations to the board.

Another area of uncertainty is the potential for international developments to take private-company reporting in different directions.

For example, the PCFRC outline states that the chair sets the committee's agenda, with input from a strategic planning subcommittee. Beyond this statement, there is little to explain how the committee selected FIN 48, FIN 46(R), and SFAS 123(R) as its priorities among existing standards. Likewise, interested parties may want to understand more about the committee's efforts to discern the needs of users. Will reliance on the four user members, possibly augmented by the users in its Resource Group, be perceived as sufficient outreach? Or will the PCFRC need to establish a more systematic process for ensuring broad input?

FASB responsiveness to PCFRC recommendations. The PCFRC has moved quickly to engage FASB on several issues and has experienced some early successes. The board's prompt decision to delay the effective date of FIN 48 for private companies should encourage private-company constituents, as should its tentative acceptance of the PCFRC's recommendations on subsequent events. But significant uncertainty remains concerning whether the committee's recommendations will lead to meaningful amendments of private-company reporting standards. In particular, will FASB be receptive to measurement and recognition exceptions for private companies, or will it maintain its historical pattern of limiting exceptions to mainly effective dates and disclosures? Only time will provide the answers.

Even if FASB were willing to make substantive revisions to GAAP in response to PCFRC proposals, other issues might limit progress on private company concerns. FASB's lengthy agenda, attributable largely to its convergence initiative, could keep both FASB and the PCFRC busy with prospective GAAP issues over the next few years. As a result, the committee's opportunity to consider existing standards—and FASB's willingness to reconsider those standards—could be limited in the near term.

User reactions to GAAP exceptions for private companies. Historically, financial statement users have expressed a strong preference for GAAP-basis financial statements. OCBOA reports have been received with less enthusiasm, and selective departures from GAAP generate concerns among many users. If the PCFRC's efforts lead to more—and more significant—GAAP exceptions for private companies, financial statement users could respond negatively.

FASB is certainly aware of the potential to damage the GAAP "brand" by incorporating too many exceptions for private companies. The issue is especially significant because the board has explicitly rejected the creation of a separate GAAP for private companies. Although this decision will undoubtedly resonate with proponents of a single system, it means that accommodations can be provided to private companies only by amending GAAP and risking its credibility. As with questions about FASB's responsiveness to the PCFRC, only time and experience will provide the answers.

International convergence and the adoption of IFRS. Another area of uncertainty is the potential for international developments to take private-company reporting in different directions. As noted earlier, SOX requires FASB to actively pursue convergence with IFRS. At the same time, the board has resolutely opposed the creation of a separate GAAP for private companies, preferring to embed exceptions into a single GAAP. This position stands in contrast to the IASB, which has drafted a complete, separate set of financial reporting standards for SMEs. The divergence in their positions seems likely to, at the very minimum, complicate the convergence process.

Earlier this year, the SEC began allowing foreign private issuers to report under IFRS without any reconciliation to U.S. GAAP. The SEC also invited comment on the possibility of allowing domestic companies to elect IFRS as an alternative to U.S. GAAP. This strong official embrace of IFRS raises further questions about which approach to private company financial reporting is likely to prevail. Will the United States adopt the IASB's SME standards? If not, is it possible these standards could emerge as a new form of OCBOA?

An Ambitious Start, but Big Questions

The creation of the PCFRC is arguably the most significant step toward separate private-company reporting standards since FASB assumed responsibility for establishing GAAP. While the new committee has made an ambitious start, the lengthy history of this issue and the pressure of current events raise many questions about the direction GAAP will take for all U.S. companies, both public and private. Anyone with an interest in the future of standards setting should pay careful attention to the PCFRC's activities. ❑

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