



## Constituents Respond to FAF Proposal to Create Private Company Standards Improvement Council

The Financial Accounting Foundation (FAF) in October 2011 issued a proposal to establish a Private Company Standards Improvement Council (PCSIC).<sup>1</sup> The most significant difference from the recommendations made by the Blue-Ribbon Panel on Standard Setting for Private Companies (the Blue-Ribbon Panel) is that, although the PCSIC would have standard-setting responsibility, it would not be autonomous.<sup>2</sup> Instead the PCSIC would work within the FASB’s due process structure to determine what exceptions or modifications should be made to U.S. GAAP for private companies. The PCSIC’s recommendations would only become part of U.S. GAAP if ratified by the FASB. This is different from the Blue-Ribbon Panel’s recommendation that the FAF create a new standard-setting board that is separate from the FASB.

The comment period on the FAF’s proposal recently ended. While some respondents supported the FAF’s proposal, others preferred having an autonomous standard-setting body. Several respondents did not support the FAF proposal because they do not believe that there should be exceptions to U.S. GAAP for private companies.

The FAF is holding public roundtables over the next several weeks to listen to the views and concerns of its constituents including users, preparers, and auditors of private company financial statements.

### Summary of Comment Letters

The FAF received over 7,300 responses, with approximately 7,000 of those identical, or nearly identical, letters based on a form letter suggested by the AICPA. The AICPA advocates establishing an autonomous standard-setting body as recommended by the Blue-Ribbon Panel and many of its members expressed similar support.

Within the remaining group of approximately 300 responses, which primarily were from private company preparers and auditors, there was mixed support for the FAF’s proposal. Respondents from mid-size and smaller accounting firms generally support the concept of a separate board. Many other respondents, including larger public accounting firms, the National Association of State Boards of Accountancy, the Institute of Management Accountants, and Financial Executives International’s

<sup>1</sup> Board of Trustees of the Financial Accounting Foundation Request for Comment: Plan to Establish the Private Company Standards Improvement Council, available at [www.accountingfoundation.org](http://www.accountingfoundation.org). See also KPMG’s Defining Issues No. 11-51, Financial Accounting Foundation Seeks Comments on Proposed Private Company Standards Improvement Council, available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

<sup>2</sup> Report to the Board of Trustees of the Financial Accounting Foundation issued by the Blue-Ribbon Panel on Standard Setting for Private Companies, available at [www.accountingfoundation.org](http://www.accountingfoundation.org). See also KPMG’s Defining Issues No. 11-3, Blue-Ribbon Panel Report Calls for Separate Standard Setter for Private Companies, available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

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Committee on Private Company Standards, expressed support for the FAF plan. The responses from state CPA societies expressed mixed views about the FAF plan.

There were a limited number of individual responses from preparers and users of private company financial statements. Of the financial statement preparers and users that did respond, a majority were not in favor of the FAF plan. However, some objected to the proposal because they believe that there should not be differences between U.S. GAAP for private companies and U.S. GAAP for public companies.

The U.S. Senate Committee on Homeland Security and Governmental Affairs also said that there should not be exceptions within U.S. GAAP for private companies. The Committee believes that exceptions made to U.S. GAAP for private companies would weaken U.S. GAAP, reduce transparency, and conflict with international standards while providing few benefits for financial statement users.

### **KPMG Comment Letter**

We support the FAF's plan to establish the PCSIC primarily because we believe that U.S. GAAP, for both public and private companies, should be established by a single standard setter. We also agree that the concerns of private company financial statement users and preparers should receive greater attention in the standard-setting process. We believe that the creation of the PCSIC with its due process that includes FASB ratification before any modifications or exceptions from U.S. GAAP are approved for private companies would create a structure that can be responsive to those concerns.

While we agree that there may be circumstances where the needs of users of private company financial statements support modifications and exceptions to U.S. GAAP, a framework will be needed to identify whether, and if so when, exceptions and modifications to U.S. GAAP should be made for private companies. That framework should be developed to address the needs of users of private company financial statements. Our views are similar to those shared by other individuals and organizations that supported the FAF's plan.

***Single Standard Setter for U.S. GAAP.*** In our view, U.S. GAAP for private companies should be based on the same fundamental concepts as the standards for public companies. Maintaining a single standard-setting body responsible for accounting standards for both public and private companies best meets this objective. The FAF proposal notes that establishing a separate standard-setting body for private companies that is not subject to the FASB's oversight and ratification could result in fundamentally different standards for private companies than for public companies. Such fundamental differences could:

- (a) Cause confusion among financial statement users that use both private and public company financial statements; and
- (b) Increase complexity for financial statement preparers and auditors of companies that may move between private company and public company status.

We believe the FASB, through its existing structure and with the aid of the PCSIC, is best suited to consider the needs of users of private company financial statements and determine whether exceptions or modifications to public company standards should be made.

**Framework Based on Needs of Financial Statement Users.** Many studies have identified concerns about financial reporting for private companies. To date, many of those studies have focused on financial statement preparers' concerns about the complexity of accounting standards. The Blue-Ribbon Panel observed that under the current standard-setting system, the needs of users of private company financial statements have not been adequately addressed. We agree that exceptions and modifications to U.S. GAAP should be based on a framework that gives primary consideration to the needs of users of private company financial statements as well as the costs and benefits of providing that information.

The FAF plan could lead to higher-quality input to the standard-setting process by giving greater consideration to the needs and concerns of users and preparers of private company financial statements. Many of the concerns about unnecessary complexity of certain accounting standards raised by preparers of private company financial statements also have been raised by public company financial statement preparers. Both desire a reduction in the unnecessary complexity of some accounting standards within U.S. GAAP. We believe that the FASB should seek solutions to reduce complexity for both public and private companies through its ongoing standard-setting activities, including the disclosure framework and conceptual framework projects.<sup>3</sup>

To the extent that the efforts of the FASB and PCSIC result in differences in recognition, measurement, presentation, or disclosure standards between public and private companies, the financial statements should be clear and transparent about which requirements are being applied. This could be accomplished by disclosing in the description of the company's accounting policies and in the independent auditor's report whether a company was applying U.S. GAAP applicable to private companies.

**Definition of Private Company.** To avoid confusion, private companies within the scope of the PCSIC's activities will need to be clearly defined. Private companies could be defined as entities without public accountability, which would be consistent with the IASB's definition for the application of IFRS for Small and Medium-sized Entities and would be similar to other jurisdictions with differential reporting frameworks.<sup>4</sup> An entity would have public accountability if it has (or is in the process of issuing) debt or equity instruments traded in a public market, or if it holds assets in a fiduciary capacity for a broad group of outsiders (e.g., depository financial institutions and insurance companies).

**Consideration of the Incorporation of IFRS into the Financial Reporting System for U.S. Public Companies.** The SEC is still considering whether and if so, how and when, IFRS might be incorporated into the financial reporting system for U.S. public companies. The FAF will need to consider the implications, if any, of the SEC's plans for the standard-setting process for public companies on private company financial

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<sup>3</sup> FASB's Disclosure Framework Project and Conceptual Framework Project, summaries available at [www.fasb.org](http://www.fasb.org).

<sup>4</sup> International Financial Reporting Standard for Small and Medium-sized Entities, available at [www.ifrs.org](http://www.ifrs.org).

reporting standards before finalizing its proposal, especially if the FASB begins incorporating IFRS into U.S. GAAP through an ongoing convergence and endorsement process. The timing and approach to incorporating IFRS into U.S. GAAP for public companies may affect the FASB's standard-setting priorities, which will need to be considered by the FAF before finalizing its plans to implement the PCSIC proposal.

## Public Roundtables

The FAF is holding four public roundtables so individuals and organizations representing private company stakeholders can engage in further dialog with the FAF about ways to address the needs and concerns of private company financial statement users and preparers in the standard-setting process. The first two roundtables were held January 18 and January 26 and the remaining roundtables are scheduled for February 7 and March 1. At the first two roundtable meetings, the moderator asked for feedback from participants on the following topics:

- The benefits and detriments of having a single standard-setting body (i.e., the FASB) as opposed to a separate autonomous standard-setting body as recommended by the Blue-Ribbon Panel;
- The structure and composition of the PCSIC, including whether or not the chairman of the PCSIC should be a FASB member as well as the number of members that should comprise the PCSIC;
- The frequency of meetings of the PCSIC;
- The oversight of the PCSIC by the FAF;
- The establishment of the framework to evaluate when exceptions or modifications to U.S. GAAP should be made; and
- The process by which the FASB would ratify the decisions of the PCSIC.

The participants' views expressed during the roundtables were consistent with the diversity of comments provided in the comment letters.

After the roundtables are completed, the FAF plans to consider the input it has received to determine what the next steps should be before reaching conclusions about whether the PCSIC should be established and if so, its specific structure. The timing of further formal action by the FAF on its proposal is uncertain until it has an opportunity to consider all of the input.

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