When Worlds Collide—How Public Interests Affect Private Companies

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Recently, a collaborative effort by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) was put forth to improve the financial reporting process for private companies. As a result, the Private Company Financial Reporting Committee (PCFRC) was formed to evaluate current accounting standards with regard to private companies vis-á-vis generally accepted accounting principles (GAAP).

By studying the financial reporting needs of private companies, the

Committee will make recommendations as to how private company financial statement preparers, users, and auditors can play a part in the standards-setting process. The issue of private company financial reporting is important because private companies continue to form the backbone of the U.S. economy.

While I agree that the needs of private companies warrant attention, the question I raise is this: Why are the FASB and AICPA, neither of which is an expert on private companies, spearheading this initiative? The FASB is responsible for setting public company standards on behalf of the Securities & Exchange Commission (SEC) and therefore becomes a de facto regulator, especially now that funding is provided through a levy on corporations. Thus FASB independence should be of paramount concern. The AICPA represents the interests of the public accounting industry. Although it is possible that the FASB should have an interest in private company reporting, it makes no sense that they would risk their objectivity and possibly their credibility by partnering with the industry representative group whose primary interest is to influence the creation of standards in order to provide revenue-building opportunities for their members. Clearly the degree of bias is unacceptable.

That said, the FASB and AICPA established the Committee to examine the issues of private company financial reporting. We at the Institute of Management Accountants (IMA®) were surprised to learn that the majority of founding PCFRC board members, in fact, have minimal private company experience. The Committee largely represents public company and public accounting backgrounds: four CPA practitioners, four financial statement preparers, and four users of private company financial statements. Odd that a committee created to address the needs of private companies has relatively little relevant experience.

This is another example of how the accounting profession in the U.S. suffers from an institutional bias skewed toward the needs of public accounting. During the past 30 years, public accounting firms have managed to influence the higher education institutions to steer prospective accounting undergraduates toward careers in public accounting—a decision that many regret shortly after graduation. This same bias will undoubtedly infect the PCFRC so that it functions as an unbalanced resource. The success or failure of the Committee hinges on the backgrounds of those on it, and I'm concerned that not only is there a clear lack of objectivity but that the Committee is not properly representative of all private company stakeholders to do the work it has set out to do.

Perhaps the increasing number of companies choosing not to go public or the number of public companies delisting from public trading in the U.S. is the motivator for the FASB and AICPA so that they may protect their own interests. It becomes quite apparent that the public-accounting-centric PCFRC will be yet another vehicle to feed business to the CPA firms.

These public auditors and CPA firms are the ones that will ultimately reap the benefits should financial reporting become mandatory for privately held companies in much the same way that Sarbanes-Oxley Act (SOX) legislation has been a public accounting gold mine. IMA supports reform and governance if they serve to enhance the way business is conducted and aren't just a money-making tactic. The real tragedy that could happen would be that the true needs of private companies are left unmet.

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It is increasingly obvious that complexity and a broadened scope of standards tend to create bureaucracy, which stifles creativity and stifles U.S. competitiveness. It might also serve to increase FASB influence at home and accounting firm revenues. How is this helpful to U.S. society in an increasingly competitive global economy? We already know that other countries don't accept the levels of complexity and heavy-handedness of U.S. regulators—witness the universal rejection of Public Company Accounting Oversight Board (PCAOB) Sarbanes-Oxley Section 404 implementation regulations.

The FASB and AICPA should have a greater appreciation for the important role that IMA plays in the profession. More than 90% of finance function professionals in the U.S. work inside organizations and do not have the CPA designation, which is focused primarily on compliance matters. The majority of our members work at privately owned, small- and mid-sized companies. Many of our members have devoted their entire careers to private company accounting and have the knowledge needed to make the FASB/AICPA initiative work. IMA represents the interests and needs of private companies vs. the revenue interests of the accounting firms.

Although IMA will be looked to as an "outreach" reference to the PCFRC, management accountants should undoubtedly have an equal number of seats at the table as do the "friends" of AICPA to voice their opinions—opinions that are likely more in alignment with the overall goals of the Committee. The management accounting profession can't continue to be the unheard voice it has been for so long.

IMA agrees that the financial reporting needs of private companies should be addressed, and the principles of transparency, sound internal controls, and credible financial statements are universal. Everyone needs solid financial information to make proper management decisions. This initiative, should it be executed successfully, has the potential to improve the performance and competitiveness of private companies.

Accounting and finance professionals of all backgrounds must begin working collaboratively to ensure that American business continues to prosper, regardless of which side of the fence we're currently on. If this doesn't happen, it's only a matter of time before sweeping reform is issued for the private sector just like the Sarbanes-Oxley Act was implemented as a result of mismanagement and broken trust.

It has been said that every great civilization began as a theocracy and ended as a bureaucracy. If you think it can't happen to the U.S., keep in mind that the growing global economy will shift influence substantially by the year 2020.

We should all learn from the mistakes of our past and not the ones we've yet to make. What do you think? Please share your thoughts with me at psharman@imanet.org. ■