

Diet GAAP and a New Framework

Recently, the FASB has made an effort to make GAAP more relevant and practical for SMEs. This effort is the prime responsibility of the Private Company Council, and the Decision Making Framework is an important tool in this process.

Rules, rules, and more rules! According to a recent article in *The Wall Street Journal*, U.S. Generally Accepted Accounting Principles (GAAP) comprise more than 25,000 pages of rules. (See Emily Chasan's "FASB's Seidman: Americans Prefer Rules to Principles" on <http://wsj.com>.) This inflation of rules over the last three decades was driven almost exclusively by the requirements of public company investors and stakeholders. Each year there's a substantial number of GAAP pronouncements that almost always add complexity but rarely add relevant value for private companies. For smaller companies, there's less relevance at a greater cost proportional to size.

As a management accountant working with privately owned small and medium-size entities (SMEs), I usually learn about the latest GAAP pronouncements through an IMA®-related activity or from an external auditor. After some level of research and

cost—in personal time and in real money for educational materials—I try to fathom the relevance of each new rule to my company. In fairness, the pronouncement may actually be relevant on some occasions but definitely not all.

Unfortunately, from the point of view of a number of SME entrepreneurs, relevance was lost many years ago. When it's time to explain "new GAAP stuff" to an SME company owner, I feel like a furry character in a Dilbert cartoon. In the best of circumstances, a little extra paperwork or record-keeping activity follows.

Can Relevance Be Restored?

The good news is that an appreciation of the importance of core accounting principles remains intact. Basic accounting principles, which are built on 500 years of tradition and pragmatic application, are by-and-large still well respected.

In December 2009, the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Foundation (FAF) announced the establishment of the Blue-Ribbon Panel on Standard Setting for Private Companies, with the National Association of State Boards of Account-

tancy (NASBA) as a third sponsor. The panel's goal was "to address how U.S. accounting standards can best meet the needs of users of private company financial statements." Members of the panel included "a cross-section of financial reporting constituencies." IMA Chair Bill Knese was a participant. The IMA Small Business Financial and Regulatory Affairs Committee (SBFRC), an IMA advocacy group that addresses issues impacting small businesses, monitored the panel's activities and submitted comment letters.

In January 2011, the Blue-Ribbon Panel released its "Report to the Board of Trustees of the Financial Accounting Foundation." Following some of the recommendations in the report, the FAF established the Private Company Council (PCC), which has two principal responsibilities: (1) to determine whether exceptions or modifications to existing GAAP are required in order to address the needs of users of private company financial statements and (2) to serve as the primary advisory body to the Financial Accounting Standards Board (FASB) for private companies for items under active consideration on the FASB's technical agenda.



Diet GAAP or Pseudo-GAAP?

From the management accountant's perspective, GAAP functions as sort of an authority. Need an answer to a difficult accounting issue? Consult the authority. If you have a differing opinion with an auditor, consult the authority.

The ultimate prize is to restore the relevance of GAAP to private companies and SMEs, reduce their cost of compliance, and encourage an open and inclusive process. On the surface, the FASB-PCC approach may not be optimal, but it's an honest attempt to solve a real problem. I characterize this as *diet* GAAP. It basically has an attitude of "same great taste, just less filling."

On June 10, 2013, the AICPA released its "Financial Reporting Framework for Small- and Medium-Sized Entities." It's a professionally recognized framework, but it isn't authoritative. It has been described as an "other comprehensive basis of accounting" (OCBOA). It isn't an authoritative *diet* GAAP; rather, it's a completely different brand that I describe as *pseudo*-GAAP.

I can envision circumstances in the near future where SME management accountants, rather than referencing GAAP as the authority, are forced into a new role as defenders of GAAP. I'm somewhat relieved that NASBA voiced its support of GAAP. In June, the organization released a statement that reaffirmed its "support of Generally Accepted Accounting Principles (GAAP) as modified by the Financial Accounting Standards Board (FASB) to meet the financial reporting needs of private companies." In the statement,

NASBA said that it "believes significant progress is being made by the Private Company Council (PCC) of the FASB. Consequently, private companies should not consider adopting the Financial Reporting Framework (FRF) for Small and Medium-Size Entities released by the American Institute of Certified Public Accountants (AICPA)."

I intend to keep a copy of this important and succinct letter and use it in the future if I'm confronted with a pseudo-GAAP dilemma. (The entire NASBA statement can be found at http://nasba.org/files/2013/06/PR_NASBA_Supports_GAAP_06131313.pdf.)

The PCC's Framework

The positive side to the AICPA's pseudo-GAAP initiative for private firms is that it adds a sense of urgency to the FASB-PCC endeavor. The PCC is facing an arduous task. There's a lot of old GAAP, and plenty of new GAAP is created every day. Each standard and industry-specific topic has to be evaluated for relevance to private firm decision makers to determine:

1. Recognition and measurement guidance,
2. Disclosure requirements,
3. Display requirements,
4. Effective date of guidance, and
5. Transition method for applying guidance.

To help understand how new GAAP pronouncements affect private companies, the PCC also is developing "The Private Company Decision-Making Framework: A Guide for Evaluating Financial

Accounting and Reporting for Private Companies."

As a management accountant working for an SME manufacturing company, I conceptualize the framework as a GAAP sieve: A skilled operator loads some GAAP into a big hopper and then shakes vigorously. The mesh allows certain kinds of GAAP to fall through and leaves relevant diet GAAP behind. After it's inspected for relevance by the PCC, the diet GAAP is packaged and sent out for comment in an open and inclusive process.

The Framework, Paragraph 2.9

The Devil is in the details, and there are a lot of details in the PCC's Framework. One issue that concerns the SBFRC is paragraph 2.9 in the Framework: "The PCC also should consider whether private companies should provide additional disclosures beyond those required by public companies. Examples might include information about the timing and amount of distributions paid to owners and income tax sharing arrangements."

Such disclosures would add additional complexity and discourage adoption by SMEs. Instead of a smaller, more relevant subset of GAAP, liberal application of paragraph 2.9 could ultimately lead to two distinct sets of standards. Worse, it could incite many SME entrepreneurs to go GAAP shopping (diet GAAP vs. pseudo-GAAP).

While the essence of paragraph 2.9 is within the mandate of the PCC, the Framework appears to be the wrong tool. Additional

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disclosures, if necessary, might best be added into broader GAAP (applicable to both private and public companies). Yet adding supplemental disclosures to SME GAAP and not to public company GAAP appears to be a violation of the principle that smaller SME firms should report less. To continue with the analogy, a sieve should reduce, not amplify.

IMA's SBFRC

As noted, the SBFRC is a committee of volunteers representing IMA accounting professionals who work for SMEs—the targeted customer group for diet GAAP. Monitoring the PCC, diet GAAP, and pseudo-GAAP isn't an easy job, and it will probably get harder when the Framework starts functioning (or fails to function). The SBFRC submitted a letter in June to the FASB and its PCC on the proposed Framework. A copy of the letter (and all other comment letters IMA has submitted) can be found at www.imanet.org/about_ima/advocacy_activity/small_business_financial_and_regulatory_affairs_co.aspx. At present, there are three PCC exposure drafts with comments due in mid-August: *Accounting for Identifiable Intangible Assets in a Business Combination*; *Accounting for Goodwill*; and *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps*.

The SBFRC volunteers could use your help. Direct involvement on the committee would be ideal since more hands make for easier lifting. If you can't become in-

involved as part of the committee, please consider commenting on issues that are important to you.

On a personal note, participation with the SBFRC at any level is a two-way street. You gain valuable insights into the future and a deeper appreciation of the issues. **SF**

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