I would be in favor of the FASB’s proposal to establish the PCSIC under the following circumstances:

1) The focus should not be on accounting for non-public entities, but rather on GAAP for small privately held business enterprises. There are many private companies that are involved in transactions and whose operations are just as sophisticated and complex as those of public entities. The entity and the users of its financial statements should make a determination as to which framework is most applicable. For many small businesses, this will also require the involvement of the entity’s independent CPA.

2) The focus of the PCSIC should be to develop standards of reporting for small private enterprises that reduce the cost of compliance to be more in line with the benefits associated with complete and reliable reporting. This should involve two specific objectives:

   - To reduce the amount and complexity of disclosures considered appropriate for the small privately held business enterprise
   - To provide alternative treatments for transactions that might require an inordinate amount of analysis, increasing the cost of compliance beyond the benefit achieved by it.

Disclosures

Unlike those of public entities and large privately held business enterprises, users of financial statements of the small privately held business enterprise generally have access to owners, executives, and senior management of the reporting entity. As a result, they are able to obtain details about the reporting entity and its operations that may not be apparent based on the information provided directly in the financial statements and related disclosures.

The emphasis should be on making users aware of issues that are worthy of additional attention without providing all of the details. Users can then decide which issues are relevant to their relationship with the reporting entity and make inquiries as appropriate. The reporting entity will generally be aware of issues that users are most likely to be concerned about and can voluntarily provide that information that its management believes will be the subject of inquiries.

Alternative Accounting Treatments

There are many areas where determining and/or applying the accounting treatment required by current generally accepted accounting principles requires analysis that is costly and time-consuming to perform. In many cases, after performing such an analysis, it is determined that a simpler accounting treatment would be appropriate, but this can only be determined after performing the costly analysis. There are other areas that require costly
analysis in order to apply required accounting standards when a simpler approach would provide information that is just as useful to financial statement users as the more complex approach but would not require the costly analysis.

An example of the first circumstance is the current accounting for variable interest entities. Unlike publicly held and large private business enterprises, small privately held business enterprises use special purpose entities more for the tax and estate planning benefits than to accomplish off balance sheet financing or to transfer unproductive assets off of the balance sheet. In addition, the analysis to determine whether or not an entity is a variable interest entity that requires consolidation is costly and requires the application of a significant amount of judgment. Without incurring the cost of expensive experts to assist in the analysis, which is not precise to begin with, it becomes even less reliable.

- In many cases, after performing the analysis, the entity determines that consolidation of a variable interest entity is not required.
- Even when it is determined that consolidation is required, in many cases the users of the financial statements are aware of the relationship between the reporting entity and the variable interest entity and consider separate rather than consolidated financial statements to be more useful in performing their analysis of the entity.

Disclosure of the relationship between the reporting entity and the potential variable interest entity is often sufficient to meet the needs of users without requiring the reporting entity to incur the cost of performing the analysis.

An example of the latter circumstance is the current accounting for deferred income taxes. Although it is understood that the liability method provides a better measure of the amount of any deferred tax assets and deferred tax liabilities than the deferred method, users of the financial statements of small privately held business enterprises often ignore deferred tax assets and liabilities. They indicate that:

- Deferred tax assets do not represent a genuine asset that enhances the net worth of the entity and, in fact, will only provide benefit if there is taxable income in the future.
- While deferred tax liabilities may represent true liabilities, they too will only require the use of entity resources if there is taxable income in the future, indicating that there will be resources with which to satisfy them.

As a result, users will tend to ignore deferred tax assets and liabilities, making a mental adjustment to equity.

The deferred method is not nearly as costly to apply to the small business enterprise as the liability method. While this method provides a less accurate and reliable measure of deferred tax assets and liabilities, these are often largely ignored anyway. At a dramatically lower cost, however, it provides a reasonable measure of deferred income taxes on the income statement, allowing users to determine what portion of the entity’s reported income would be available for debt service, return to investors, or investment.

Thank you for the opportunity to share my views.

--

Mark Dauberman