RESPONSE TO REQUEST FOR COMMENT ON PLAN TO ESTABLISH THE PRIVATE COMPANY STANDARDS IMPROVEMENT COUNCIL

First a little background. I have never responded to a request for comment in my 33 years of experience in public accounting at small public accounting firms. I guess the reason is that I’m not very articulate and sometimes feel intimidated by those that I perceive as being more knowledgeable of “THE STANDARDS”, whether they relate to accounting, auditing, not-for-profit, government, etc. However, the more I think about it that is exactly why I should respond to the request for comment. If I can’t understand the reasoning behind a particular requirement with all my years of training and experience, then how can I expect my small business client or his/her banker who are generally the only users?

I understand 99% of the reasoning for the various standards relating to not-for-profit and government accounting, but when it comes to our small commercial entities I just throw up my hands in surrender, because we currently have only three choices.

- Follow the standards no matter how ridiculous they are when applied to a small business. This costs our firm a lot. We must stay up to date on the issuance of all standards. Then we must understand them well enough to make a decision as to whether they apply to our clients or not. Our small businesses generally do not have anyone in-house that has sufficient accounting background to thoroughly understand many standards which brings up independence issues. Next there’s the cost of implementing. Guess who pays for this? Actually it’s a combination of the firm and our clients because we can’t pass the total cost onto our small clients. The additional requirements don’t do anything for them.

- Don’t follow the standards which is what a lot of small businesses do already. They use An Other Comprehensive Basis of Accounting (OCBOA) such as cash or income tax basis which is fine with them. When you say something to our local bankers (the users) about reporting for small businesses they respond that they would like GAAP financial statements. So right now they are getting less than the want because GAAP is too costly to implement.

- Do nothing. Many clients don’t know any better and neither do their bankers. However, the CPA firms ultimately pay the price when it comes time for peer review. This is where I have a little different experience than other responders. We have always held our firm to the highest professional standards and we were a founding member of the AICPA Private Companies Practice Section (PCPS) which means that we have been undergoing peer reviews since 1978. As a result we developed an interest in also performing peer reviews. Both partners in our firm are experienced peer reviewers. I have also been a member of the NYSSCPAs Peer Review Committee for 16 years. You would not believe the number of times that firms are cited for not reporting on financial statements in accordance with standards. The end result would usually be that the peer reviewer, technical reviewer and peer review committee have to determine how significant that departure really is to a users understanding of the client’s financial status in order to determine the type of peer review report that should be issued. In addition, the CPA often decides to change reporting to an OCBOA in order to avoid issues in the future. Therefore, the level of reporting actually goes backwards.
Okay that was more than a little background; however, it all needs to be understood in order to appropriately address the major problems related to the Private Company Standards Improvement Council

These are my responses to the establishment PCSIC as currently set forth:

1. The first indication of a problem is the name of the Council. How can you improve standards that don’t even exist? Per the plan the purpose of the PCSIC purpose is to “improve the standard-setting process for private companies”; however, there currently isn’t any standard-setting process for private companies. That’s the problem.

2. Critical Responsibilities – The overall responsibility of the PCSIC would be to “determine whether exceptions or modifications to US GAAP are required to address the needs of users of private company financial statements.”
   a. I know this is very difficult to implement; however, the real issue at our level is not between public and private, but between big and small. There are large private companies that shouldn’t be treated any differently than public companies. I know this would be quite arbitrary; however, IRS has determined that it is appropriate to establish different requirements based on size of company.
   b. Wow! I’ve totally misunderstood this project from the beginning. Now I’m really upset. I thought the purpose was to make it easier for private companies to be in conformance with GAAP. Now I see that it is to determine if changes are required to meet needs of users. Does that make any sense? Why would the users need any exceptions or modifications to US GAAP for private companies?
   c. The only group of users that I think would want any changes to US GAAP would be the local bankers for small companies. Many times they now receive financial statements prepared using Other Comprehensive Basis of Accounting (OCBOA) such as cash or income tax basis because GAAP is too costly for small companies to implement. They would certainly appreciate a step up to “GAAP-lite” statements, but I can’t think of any other situations where users would benefit.
   d. Therefore, since you are focusing on user needs for private companies (not just small), I don’t know when you would ever determine that exceptions or modifications to US GAAP are required. This seems like a ploy to me.
   e. Small businesses need help now! This process sounds like it would take many years. We don’t need the additional stumbling block of the FASB. The Big GAAP/Little GAAP issue has been around my entire career and the FASB didn’t do anything. The problem is that the FASB has to stay focused on public companies. If public companies were more ethical and less greedy the FASB would have time to address the concerns of small businesses. However, that’s not going to happen so that’s where they need to continue to focus for the good of our country.
   f. As part of the background on the plan to establish the PCSIC, you state that “demands of capital markets have made it more important to maintain the comparability of financial reporting among disparate companies . . . .” This doesn’t really apply to small companies where there is already a loss of comparability due to the use of OCBOA. (Please don’t take OCBOA away as a compromise.)
The current standards need to be reviewed immediately. There are standards out there just don’t make any sense for small businesses and they could be exempted from them in short order. It wouldn’t take long for a panel of professionals that work in the trenches all the time with small businesses to put a list together.

3. Membership – Here is another indication where the FAF just doesn’t get it. “Members would include . . . significant experience using, preparing, and auditing (and/or compiling and reviewing) . . .” In our world banks (generally only users) do not require most commercial entities to be audited, so all we are talking about are compilations and reviews. It seems like compiling and reviewing was just put in as an afterthought. Also, wouldn’t it be important to require a majority of the PCSIC to have significant experience with private company financial statements?

4. Meetings – This is another indication of how seriously the FAF takes this issue. The PCSIC would meet 4-6 times per year. As stated above, this issue needs to be tackled now which means that a serious investment of time should take place now. This project needs to be placed on a fast track, but also allowing time for serious deliberations.

5. Oversight – The PCSIC is to be overseen for 3 years by a Private Company Review Committee which is a subcommittee of FAF trustees. The background on the plan indicates that the Review Committee should be chaired by a Trustee who has had substantial private company experience and “include among its members Trustees who also have significant experience” with private companies. There is no mention as to the size of this subcommittee and whether the majority of the members would actually have private company experience.

CONCLUSION

I did not participate in the letter-writing campaign sponsored by the AICPA. I skimmed over the recommendations of the Blue Ribbon when they came out but do not recall any details other the recommendation of a separate board. Therefore, my thoughts are based solely on my professional experience and on the information that is contained in the Plan for the PCSIC.

I do not believe that the Plan set forth by the FAF appropriately addresses the problems that I think are the most significant in US accounting today for the following reasons:

- I believe the issue is big vs. little. There is already an “inferior” basis of accounting that is being used more and more-OCBOA. Wouldn’t it be in the better interest of users to have modified GAAP or GAAP-lite?
- I believe that FASB must focus its resources on public and large companies as they are the ones that have the complex transactions and sophisticated users. I don’t believe that a Council that is ultimately overseen by FASB is appropriate in this situation.
- I also believe that FAF has not succeeded in its almost 40 years of existence of fulfilling one of its objectives of “ensuring that those standards those standards take into account the individual needs and circumstances of . . . entities that issue financial statements . . . specifically related to relevance, complexity, and costs versus benefits.” Why now??