

## **AICPA's Proposed Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs™)**

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The concept of "Little GAAP" (differential accounting standards for private companies) has been around for quite a long time. However, over the past several years the discussion has gone from sublime A&A conference fodder to a full-blown raging debate, with supporters and naysayers alike digging in their heels. Rekindling of the fire began in December 2009 when the AICPA, the Financial Accounting Foundation (FAF) – FASB's parent -, and the National Association of State Boards of Accountancy (NASBA) formed the Blue Ribbon Panel on Standard Setting for Private Companies to address how accounting standards might best meet the needs of users of U.S. private company financial statements. Supporters of Little GAAP got excited when they read the panel's January 2011 report recommending that a separate private company standards board should be formed and a differential framework created to facilitate justifiable Little GAAP. Alas, in the end it was not to be. In March 2011, the FAF formed a working group to consider standard-setting for nonpublic entities, and in May 2012, announced the establishment of the Private Company Council (PCC), a new body tasked specifically to improve the process of setting U.S. GAAP standards for private companies. The AICPA's reaction was swift and to the point in a press release,<sup>1</sup> which included the following statements:

*"We are profoundly disappointed that the Financial Accounting Foundation (FAF) is not proposing to create a new independent board to set differences in U.S. GAAP standards, where appropriate, for privately held companies."*

*"The pent up frustration we are witnessing by the private company constituency is a direct result of [the FASB's] public company focus and not seeing that differences can be and are appropriate for private companies and their financial statement users."*

*"... the FASB cannot be sufficiently restructured or possess enough of the essential private company representation needed to set GAAP differences for private companies."*

Two weeks later, the AICPA Governing Council overwhelmingly approved a resolution<sup>2</sup> that included the following statements (presumably in order to send a strong message to the FAF):

*"Because the Financial Accounting Foundation's proposal does not contain the establishment of a board under the Financial Accounting Foundation empowered to set differences in U.S. GAAP standards where appropriate for privately-held companies, which is the preference of this Council, and if the Financial Accounting Foundation's proposal is not modified to include such a board under the Financial Accounting Foundation, this Council directs the AICPA Board of Directors to consider all options, including consideration of other established independent standard-setting bodies as the standard setter for U.S. GAAP for private companies, the creation of a committee or board within the AICPA or a standard-setting body as a separate entity, to develop private company generally accepted accounting principles (PCGAAP) or a comprehensive private company-specific basis of accounting that would deliver meaningful, lasting improvement to private company financial reporting consistent with the Blue-Ribbon Panel recommendations."*

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<sup>1</sup> "Statement from Barry Melancon, AICPA President and CEO, and Paul Stahlin, AICPA Chair, Addressing FAF's Failure to Create an Independent Standard Setting Board for Private Company Financial Reporting" (October 04, 2011). Accessed at [www.aicpa.org](http://www.aicpa.org).

<sup>2</sup> "Minutes of the AICPA Fall Meeting of Council/Annual Member's Meeting" (October 17-19, 2011). Accessed at [www.aicpa.org](http://www.aicpa.org).

On the same day that the FAF announced it was creating the PCC, the AICPA also announced that it would develop and release a new Financial Reporting Framework for Small and Medium-sized Entities (FRF for SMEs<sup>TM</sup>), as an “other comprehensive basis of accounting” (OCBOA). According to the AICPA’s website, “Millions of private companies do not need to use or are not required to provide stakeholders financial statements prepared in accordance with U.S. GAAP, but want an accounting system that has undergone public comment.” Additionally, a senior technical adviser for accounting standards at the AICPA has said, “in many cases GAAP is unnecessary and therefore not the best solution for a small or medium-size enterprise.”

With this in mind, the AICPA developed FRF for SMEs<sup>TM</sup> and issued an exposure draft on the new framework in November 2012 with a comment period that ended in January 2013. After considering the written comments received, FRF for SMEs<sup>TM</sup> was launched on June 10, 2013, and became immediately available for use at that time. In its press releases, the AICPA is calling FRF for SMEs<sup>TM</sup> a blend of traditional accounting and accrual income tax accounting.

FRF for SMEs<sup>TM</sup> is 206 pages long and includes 31 separate chapters of detailed material covering a wide range of accounting topics, from basic financial statement concepts all the way through foreign currency translation.

Overall points regarding FRF for SMEs<sup>TM</sup> include:

- FRF for SMEs<sup>TM</sup> does not define what a SME is.
- FRF for SMEs<sup>TM</sup> is intended to be used by SMEs that do not have to prepare U.S. GAAP financial statements.
- Users of financial statements prepared using FRF for SMEs<sup>TM</sup> are assumed to have direct access to the business owner or manager.
- The use of FRF for SMEs<sup>TM</sup> is not intended for entities that expect to broaden ownership interests in the business or take it public someday.
- FRF for SMEs<sup>TM</sup> is not intended to be used by not-for-profit entities.
- FRF for SMEs<sup>TM</sup> is an OCBOA that refines the current income tax basis of accounting.
- There are no definitive requirements for OCBOAs, including FRF for SMEs<sup>TM</sup>.
- FRF for SMEs<sup>TM</sup> is based on general accounting principles currently used in practice today.
- FRF for SMEs<sup>TM</sup> is NOT authoritative – it will NOT be approved by the FASB or any senior technical committee of the AICPA.
- FRF for SMEs<sup>TM</sup> was developed by an AICPA task force.
- Performing a compilation, review, or audit on financial statements prepared using FRF for SMEs<sup>TM</sup> will follow the current OCBOA guidance.
- FRF for SMEs<sup>TM</sup> uses historical cost as its foundation and not fair value accounting.
- The concept of “comprehensive income” does not exist under FRF for SMEs<sup>TM</sup>.
- Disclosures in financial statements prepared using FRF for SMEs<sup>TM</sup> will be the same as (or similar to) those for the same (or similar) items in U.S. GAAP financial statements.
- The AICPA’s FRF for SMEs<sup>TM</sup> task force and the FAF’s new Private Company Council (PCC) are not the same organization.
- The PCC is working on authoritative “Little GAAP.”
- The FRF for SMEs<sup>TM</sup> task force has developed a new nonauthoritative OCBOA.
- FRF for SMEs<sup>TM</sup> is meant to line up with the U.S. Tax Code.

Whenever something “new and different” comes along, there are always going to be those who wholeheartedly endorse it and those who vehemently oppose it. This would certainly appear to be the case for FRF for SMEs™ thus far as seen in some of the initial reactions to the AICPA’s effort in this area, particularly those of NASBA, as follows.

**January 28, 2013** – The NASBA Board has significant concerns that the AICPA’s initiative to develop a non-authoritative financial framework will confuse practitioners, preparers, users, and the public at large for many reasons and at many levels. Most importantly, the Board supports the Financial Accounting Foundation’s formation of the Private Company Council (PCC) and firmly believes it must be given the opportunity to develop exceptions or modifications to generally accepted accounting principles for private companies through properly sanctioned and recognized standard-setting processes. Because of these concerns, the NASBA Board strongly urges the AICPA to either table or withdraw the FRF-SME proposal to allow the PCC to singularly, and without confusion, fulfill its role to improve the process of setting accounting standards for private companies through its voice with the Financial Accounting Standards Board.

**June 13, 2013** – NASBA 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) on Monday. “At a time when accountability and transparency of those in authority is scrutinized, it is troubling that a non-authoritative proposal to significantly weaken the financial reporting of private companies and public protection is even being suggested,” said Gaylen R. Hansen, CPA, Chair of NASBA.

AICPA president and CEO Barry Melancon quickly defended the new framework in a letter to state society CEOs in which he wrote, “As you may have seen earlier today, NASBA has issued a press release indicating its support of GAAP for private companies and its opposition to the AICPA’s recently released FRF for SMEs. This announcement was not a surprise, as NASBA had previously raised objections to our efforts to offer this alternative, non-GAAP option to the small business community. However, since you may be asked by your state boards of accountancy as well as members about the recent press release, I want to share with you some key points that may be relevant to conversations you may have on this matter.” Melancon pointed out that OCBOAs have been used as an alternative to GAAP for over 40 years without any objections raised by NASBA or other parties and that the AICPA’s recently released OCBOA for small and medium-sized enterprises is in line with this long tradition of alternative accounting options available to private businesses.

In summary, the AICPA’s Financial Reporting Framework for Small and Medium-sized Entities, FRF for SMEs™, is a new OCBOA, in this case, a blend of traditional accounting and accrual income tax accounting, released on June 10, 2013 and available for use immediately. But the question is: will financial statements prepared using FRF for SMEs™ be accepted by bankers and other users? At this point, we will all just have to wait and see.