



LETTER OF COMMENT NO. 41

February 10, 2008

Ms. Teresa S. Polley  
Chief Operating Officer  
The Financial Accounting Foundation  
401 Merritt 7  
Norwalk, Connecticut 06856-5116

Dear Ms. Polley:

The Chairman of the Financial Accounting Standards Advisory Council (FASAC), Mr. Dennis Chookaszian, has asked FASAC members to “respond as individuals in order to provide the FAF with a broad range of views” regarding the FAF’s *Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB* (the “FAF Proposal”). Accordingly, I am writing to provide my individual view, but in this instance from the perspective of private company constituents in the United States that my FASAC membership is intended to represent. (By private companies, I am referring to nonpublic entities that do not plan in the foreseeable future to access the public, regulated markets.)

In addition to being a FASAC member, I am a member of the FASB’s Small Business Advisory Committee (SBAC), the past chairman of Financial Executive International’s Committee on Private Companies’ Accounting Standards Subcommittee (the CPC), a CPA for thirty years, and a preparer of GAAP – based financial statements for both public and private entities.

My comments are intended first, to provide the FAF anecdotal observations of how some private company constituents are viewing the FAF Proposal, and second, to provide in an advisory role how the FAF should respond to these private company constituent observations.

### **Observations**

Private company constituents view the FAF Proposal solely as a means to ease and assist convergence of GAAP and IFRS for global public companies that access global regulated capital markets. The FAF Proposal appears to be part of a convergence roadmap that will be followed over the next five years.

Private company constituents are asking what the impact of convergence will be on their financial reporting needs. Questions have been raised as to whether private companies will move to IFRS, or stay on US GAAP, or move to a separate set of standards tailored for small and medium-sized entities, such as the draft SME standards of the IASB. Private company constituents have noted that there is an absence in the FAF Proposal of

(a) an acknowledgement that private companies will continue to be constituents during and after convergence, and (b) that alternative financial reporting standards for private companies will even be considered in the development of the roadmap.

Private company users have elsewhere pointed out that by definition, their financial statement users are not equity investors seeking information, otherwise not available, in order to perform equity valuations. The overwhelming number of users of private company financial statements are lending banks (almost all asset-based lenders), and closely-held owners who demand accountability of management. The number of these private companies in the US that prepare GAAP - based financial statements exceeds the number of US public companies by a considerable multiple. They do not like to be left out of convergence and restructuring conversations that appear to be tailored for public companies only.

In recent years, participation of private company constituents in the setting of US GAAP has increased substantially. The FASB has made extraordinary and commendable efforts to be responsive, including the establishment of the SBAC, the Private Company Financial Reporting Committee, and additions to the FASB staff in order to work with private company constituents. The FASB has also interacted more with those professional organizations, such as FEI's CPC and the AICPA's Task Force on Private Company Financial Reporting, that represent private company constituents. These constituents have observed and appreciated comments from FASB Chairman Bob Herz regarding the need to consider private company financial statement users in the convergence process, such as his recent speech at the FEI's New Jersey chapter meeting and his comments in the February 2008 issue of the *Journal of Accountancy*.

Private company constituents have also noted that one FASB member, George Batavick, has been a primary point of contact, including his chairing of the SBAC. Private company constituents are concerned that reducing the size of the board from seven to five members will mean less effectiveness in their participation in the standards setting process.

In addition, private company constituents are concerned by the lack of acknowledgment of the impact of restructuring and convergence on them in the FAF proposal. With this absence of *any* guidance by the FAF on where private company financial reporting may be in the next five years, private company constituents are unclear as to whether their interactions in the standard setting process are fruitful or if their current participation will ultimately not matter when convergence is complete. The danger of such silence at the FAF level can lead to the renewal of recent calls in the private company community to convene the equivalent of a Wheat Committee by professional organizations that represent private company interests.

#### **Advise based on these observations**

Based on the above observations, my advice to the FAF is to incorporate the following in its final decisions regarding the FAF Proposal:

- (1) If it is the intention of the FAF in its restructurings to represent the interests of private companies, it should clearly state so. (Or if, not, then clearly state that it does not.)
- (2) The FAF should explain how a reduction in the number of FASB board members from seven to five will benefit private company constituents, as opposed to what appears to be a reduction in access to the board.
- (3) As part of its roadmap to convergence, the FAF should formally acknowledge the possible routes on the map for private company financial reporting. This would include acknowledging these possibilities:
  - Full conversion to IFRS
  - Adoption of the IASB's SMEs
  - Continuation indefinitely under US GAAP
  - Other alternatives
- (4) The FAF should include in its roadmap the milestones needed in order for the standard setters and their private company councils, committees, and constituents to make the proper decisions over the next five years.
- (5) In restructuring the make-up of the FAF's trustees, it would be helpful to appoint one or more trustees to the FAF who have knowledge of and interaction with private company constituents. The trustee(s) could be a partner in a small, local CPA firm, or a banker with knowledge of how private company financial statements are used to make assets-based loans, or a CFO of a private company who prepares financial statements and interacts with auditors and users. The trustee(s) should have both a technical background and a representational presence in a professional organization supportive of private companies. The trustee(s) would be charged to work closely in an oversight role with the FASB, the IASB, and private company constituents, and be responsible to educate all FAF trustees on private company interests. The goal would be to ensure that milestones along the convergence roadmap fully incorporate private companies.

In conclusion, private company constituents have noted and appreciated the improved environment in the standard setting process. However, silence by the FAF on building the convergence roadmap can cause private companies to again question if their user needs are being met. My advice is that the FAF needs to speak clearly on this.

Sincerely,

A handwritten signature in black ink, appearing to read "E.A. Thrower". The signature is fluid and cursive, with a large initial "E.A." and a long, sweeping tail.

Andy Thrower