
Financial Accounting Standards Board Private Company Council

Issued: December 23, 2013

Private Company Decision-Making Framework

A Guide for Evaluating Financial Accounting and
Reporting for Private Companies

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A Guide for Evaluating Financial Accounting and Reporting for Private Companies

CONTENTS

	Page Numbers
Introduction and Background	1–2
The Purpose of This Guide	2
Scope	2–4
Assessment of Differential Factors.....	4–5
Significant Differential Factors and Their Implications for Financial Reporting.....	6–10
I. Number of Primary Users and Their Access to Management.....	6–7
II. Investment Strategies of Primary Users	7–8
III. Ownership and Capital Structure	8–9
IV. Accounting Resources	9–10
V. Learning about New Financial Reporting Guidance	10
Guide.....	11–30
1: Determining Recognition and Measurement Guidance.....	11–14
2: Determining Disclosure Requirements.....	15–18
3: Determining Display Requirements.....	19–20
4: Determining the Effective Date of Guidance	21–22
5: Determining the Transition Method for Applying Guidance	23–25
Appendix: Basis for Conclusions.....	31–50
Introduction	31
All-or-Nothing Approach of Applying Alternatives within Recognition and Measurement Guidance	31–32
1: Determining Recognition and Measurement Guidance.....	32–39
2: Determining Disclosure Requirements.....	40–43
3: Determining Display Requirements.....	44–46
4: Determining the Effective Date of Guidance	46–48
5: Determining the Transition Method for Applying Guidance	48–50

Introduction and Background

1. The private company decision-making framework (Guide) is part of the ongoing commitment of the Financial Accounting Standards Board (Board) and the Private Company Council (PCC) to consider the needs of both users and preparers of private company financial statements. The development of a decision-making framework was one of the most important recommendations included in the January 2011 *Report to the Board of Trustees of the Financial Accounting Foundation* by the Blue-Ribbon Panel on Standard Setting for Private Companies. It also is expected that the Board and the PCC's identification of cost-effective alternatives for private companies through the use of the Guide will benefit some of the Board's public company, not-for-profit organization, and employee benefit plan standard-setting activities.

2. In October 2011, the Financial Accounting Foundation (FAF) issued a request for comment on its *Plan to Establish the Private Company Standards Improvement Council*. Under that proposal, one of the responsibilities of the council would be to develop, jointly with the Board, criteria for determining whether and in what circumstances alternatives within U.S. generally accepted accounting principles (GAAP) are warranted for private companies. In May 2012, the FAF Board of Trustees issued a Final Report, *Establishment of the Private Company Council*. The PCC was created to improve the standard-setting process for private companies.

3. On July 31, 2012, after consultation with the Board, the FASB staff issued a Discussion Paper, *Private Company Decision-Making Framework: A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*, to gather input from interested stakeholders on a framework for deciding whether and in what circumstances to provide alternatives for private companies within U.S. GAAP.

4. During the initial PCC meetings, the Board and the PCC deliberated the comments received on the 2012 Discussion Paper. On April 15, 2013, the Board and the PCC issued an updated Invitation to Comment, *Private Company Decision-Making Framework—A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, which reflected the views of the Board and the PCC after considering respondents' comments as well as the views received through other outreach initiatives on the 2012 Discussion Paper.

5. On July 16, 2013, the Board and the PCC redeliberated the 2013 Invitation to Comment on the basis of feedback received and finalized the Guide. Ultimately, this Guide reflects input received from a significant number of stakeholders representing diverse backgrounds about (a) their experiences using, preparing, auditing, reviewing, and compiling private company financial

statements and (b) their perspectives on the factors that differentiate the financial reporting considerations of private companies and public companies.

6. Using this Guide, the PCC will develop, deliberate, and formally vote on proposed alternatives for private companies within U.S. GAAP. Subject to endorsement by the Board, the proposed alternatives will be exposed for public comment. At the conclusion of the public comment process, the PCC will redeliberate the proposed alternatives and then submit them to the Board for a final decision on endorsement. The Board and the PCC also will use this Guide to consider private company issues in standard-setting projects under active consideration on the Board's technical agenda.

The Purpose of This Guide

7. The primary purpose of this Guide is to assist the Board and the PCC in determining whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under U.S. GAAP. The assessment of significant differential factors between private companies and public companies is considered to be an important source of input in developing this Guide.

8. This Guide provides considerations for the PCC and the Board in making user-relevance and cost-benefit evaluations for private companies under the existing conceptual framework. The Guide is intended to be a tool to help the Board and the PCC identify differential information needs of users of public company financial statements and users of private company financial statements and to identify opportunities to reduce the complexity and costs of preparing financial statements in accordance with U.S. GAAP.

9. This Guide discusses the following five areas in which financial accounting and reporting guidance might differ for private companies and public companies:

- a. Recognition and measurement
- b. Disclosures
- c. Display (or presentation)
- d. Effective date
- e. Transition method.

10. This Guide describes each of the areas listed above. Those descriptions focus on the criteria to be used in each area to evaluate whether to permit alternative guidance for private companies within U.S. GAAP. The appendix explains the basis for the conclusions in each of those five areas.

Scope

11. As part of a separate but concurrent project on the definition of a public business entity, the Board established which types of companies would be

considered public business entities to distinguish between different types of entities for standard-setting purposes and to determine which business entities should be included in the scope of this Guide. The definition excludes a not-for-profit entity within the scope of Topic 958 or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.

12. Business entities that are within the scope of this Guide are those for which the Board and the PCC would consider potential alternatives within U.S. GAAP. However, the Board acknowledges that decisions about whether an entity may apply permitted alternatives within U.S. GAAP ultimately may be determined by regulators, lenders and other creditors, or other financial statement users that require U.S. GAAP financial statements. The Board decided that a business entity is not within the scope of this Guide if it meets any one of the following criteria:

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

13. A noteworthy difference between the Board's decisions and some of the definitions of a *nonpublic entity* in existing U.S. GAAP is that a consolidated subsidiary of a public company would not be excluded from the scope of this Guide unless it meets at least one of the five characteristics in paragraph 12 above. Therefore, those subsidiaries of a public company would be included in

the scope of this Guide and would be eligible to be considered by the Board and the PCC for potential alternatives within U.S. GAAP within their standalone financial statements.

14. If an entity is within the scope of this Guide, that entity may not necessarily be allowed to apply all financial accounting and reporting alternatives within U.S. GAAP that are made available to business entities that are within the scope of this Guide. The Board and the PCC will consider factors such as user needs, on a standard-by-standard basis, when determining which business entities within the scope of this Guide will be eligible to apply accounting and reporting alternatives within U.S. GAAP. The Board also may evaluate whether a particular accounting or reporting alternative that is permitted to be applied by a business entity within the scope of this Guide should be extended to a public business entity, a not-for-profit organization, or an employee benefit plan. The types of accounting alternatives within U.S. GAAP that the Board likely will consider extending to entities outside the scope of this Guide include accounting alternatives that (a) reduce cost and complexity and (b) are not provided to private companies to meet differential user needs.

15. The Board's decisions about the types of business entities that would not be included in the scope of this Guide and the basis for conclusions for those decisions are provided in FASB Accounting Standards Update No. 2013-12, *Definition of a Public Business Entity—An Addition to the Master Glossary*.

Assessment of Differential Factors

16. In July 2011, the FASB staff completed an assessment of (a) how and why the needs of users of private company financial statements may differ from the needs of users of public company financial statements and (b) how the cost-benefit considerations of financial reporting may vary between private companies and public companies. The assessment identified the following five significant factors that in varying degrees may differentiate the financial reporting considerations of private companies from those of public companies:

- I. Number of primary users and their access to management
- II. Investment strategies of primary users
- III. Ownership and capital structure
- IV. Accounting resources
- V. Learning about new financial reporting guidance.

Paragraphs DF1–DF13 of this Guide explain those factors and their implications for private company financial reporting.

17. The assessment summarizes what the Board has learned from input provided by a variety of private company stakeholders over the past few years and from its own research and papers published on the topic of private company financial reporting. The Board's sources include input from FASB advisory groups, including the Private Company Financial Reporting Committee and the

Small Business Advisory Committee, comments from those who participated in the Board's general and project-specific roundtables held specifically for nonpublic entity stakeholders, comment letter responses, targeted discussions with various individuals and organizations, and comments by members of the Blue-Ribbon Panel on Standard Setting for Private Companies. The Board also considered a number of reports and publications prepared by accounting firms and organizations such as the American Institute of Certified Public Accountants and Financial Executives International.

18. As part of its assessment process, the Board formed a 10-member working group—the Private Company Resource Group—to advise the Board in developing this Guide. The Private Company Resource Group included users, preparers, and auditors of private company financial statements, along with an academic representative and the chairman of the Private Company Financial Reporting Committee, who all met as a group three times during 2011. Individual members of the committee spoke with the FASB staff several times during 2011 and 2012.

Significant Differential Factors and Their Implications for Financial Reporting

DF1. The following summarizes the five significant private company differential factors and their implications for private company financial reporting. The five differential factors were identified on the basis of an assessment about how and why the needs of users of private company financial statements may differ from the needs of those that use public company financial statements. It also summarizes how the cost-benefit considerations of financial reporting may vary between private companies and public companies. That assessment captures the most common characteristics that may differentiate private company and public company financial statement user needs and preparer considerations. As a result, the observations included in this Guide do not necessarily apply to all private company or public company financial statement stakeholders. Accordingly, the information included in this analysis may not be applicable to all alternatives because of the large number and varied characteristics of companies that prepare financial statements in accordance with U.S. GAAP and the different needs of their stakeholders.

Significant Differential Factors:

- I. Number of primary users and their access to management
- II. Investment strategies of primary users
- III. Ownership and capital structure
- IV. Accounting resources
- V. Learning about new financial reporting guidance.

I. Number of Primary Users and Their Access to Management

DF2. While the types of primary users (investors, lenders, and other creditors) do not vary significantly between private companies and public companies, the number of each type of primary user generally may be significantly less for private companies. Because private companies often have fewer financial statement users, those users also may have greater influence on preparers because they tend to provide a larger percentage of resources to private companies when compared with typical users of public companies. As a result, users of private company financial statements have continuous access to management and the ability to obtain financial information throughout the year. That access creates less demand for interim financial statements and a potential willingness to accept a greater lag in timing of when audited or reviewed financial statements are made available for issuance. Generally, there are fewer restrictions on the ability to share selective financial information with individual

users of private company financial statements. In contrast, there generally are more users of public company financial statements with less economic leverage and generally more restrictions on the ability to share selective financial information with those users. That creates greater demand for timelier (interim and annual reports) and more detailed general-purpose financial statements in a public company environment.

Implications

DF3. Access to management as a differentiating factor must be considered carefully. Taken to the extreme, access to management arguably could obviate the need for issuing financial statements in the private company environment.

DF4. In terms of disclosure implications, access to management may affect the information provided in footnotes. That is because as long as footnotes contain sufficient relevant information to inform users of the significant economic activities of the entity during the year, follow-up access to management should enable primary users of private company financial statements to seek the additional information they require. Thus, disclosures for private companies need to provide the information necessary to enable users to ask management follow-up questions that would fulfill their information needs, that is, the red-flag approach.

DF5. In terms of recognition and measurement implications, access to management cannot be a primary differentiating factor because U.S. GAAP financial statements are general purpose and must serve the needs of all users to whom they are provided. Failure to recognize or measure relevant financial information would hinder users' ability to understand the economics of the company, thereby hindering the ability to identify the questions to ask management. Financial statements must contain a consistent base amount of information that permits all users to obtain an understanding of the key economic activities and changes in those activities. That generally means that access to management should have no implications on whether there should be recognition and measurement alternatives for private companies within U.S. GAAP. That supports the concept that recognition and measurement differences for private companies within U.S. GAAP should be driven primarily by relevance and secondarily by cost and complexity considerations. However, once it has been decided that a recognition and measurement alternative should be provided, access to management can be considered in evaluating potential alternatives for private companies within U.S. GAAP.

II. Investment Strategies of Primary Users

DF6. Users of private company financial statements have little or no access to public markets to exit their investments in the company before the end of their defined terms, if such defined terms even exist. Private company investors and

lenders, therefore, have significantly less ability to realize interim changes in the value of their claims on the company. As a result, users of private company financial statements may have a greater focus on cash that can be realized from their investments, including dividends, interest, repayment of principal, possible buyouts, business combinations, or, less frequently, initial public offerings, as the sources for their investment return. Investors and lenders in public companies also look to those sources of investment return, but they have the ability to realize immediately current changes in value of the securities of the company through sales in public markets or by taking short-selling positions.

Implications

DF7. Those differences in investment strategies may influence the importance that users place on financial statement amounts and disclosures. Lenders and other creditors are concerned most about financial statement amounts and notes that affect reported amounts of cash, liquidity, and cash flow from operations available to service debt. The Board and the PCC were told that when evaluating a private company's earnings, typical financial statement users focus on "cash-adjusted earnings" from operations (for example, earnings before interest, taxes, depreciation, and amortization [EBITDA], with some additional noncash adjustments). Many private company investors focus on accounting and disclosure requirements affecting cash (for dividend payments) and adjusted EBITDA for purposes of applying a valuation multiple to estimate a value for their securities. Public company investors, lenders, and analysts also focus on similar information as typical users of private company financial statements, but they often have broader and more diverse financial statement needs and commonly focus more on assessing the value of the entity as a whole to determine how to allocate capital. While cash-adjusted earnings also are important to many public company users, those users often use U.S. GAAP financial statements to satisfy different objectives than private company users and they are more likely to focus on additional metrics depending on their investment strategies. Most private company investors in nonfinancial institutions indicate that they are less interested in accounting guidance that does not affect reported cash amounts or probable future cash flows. They also are less interested in accounting guidance that produces or results in volatility in reported earnings and asset and liability values resulting from underlying changes in fair value that are expected to reverse contractually in the future if the company has the intent and ability to hold the related instrument to maturity or term (for example, an investment in debt securities, the asset or liability associated with an interest rate swap agreement, or the entity's own debt).

III. Ownership and Capital Structure

DF8. The capital structure and capital funding of private companies vary from that of public companies, in part because of the strong focus by private companies on income taxes, estate taxes, succession planning, restrictions on

who can hold their stock and the transferability of that stock, and limitations on their exposure to personal liability and loss. A large number of private companies are structured as pass-through entities (that is, entities that are not subject to income tax; rather, the entity's owners are individually taxed on the entity's earnings). Common private company ownership structures include S corporations; limited liability companies; general, limited, limited liability, or family limited partnerships; sole proprietorships; and trusts, such as employee stock ownership plans. Many private companies have multiple entities under common ownership, which often results in transactions with affiliates and other related parties, as well as guarantees and cross-collateral arrangements with lenders. In contrast, the most common form of public company structure is the C corporation. The differences in ownership and capital structures between private companies and public companies could provide a basis for providing different information (less or perhaps even more) from that provided by public companies about transactions with affiliates and other related parties to users of private company financial statements.

Implications

DF9. The typical types of ownership and capital structures of private companies versus public companies should be considered in evaluating the applicability and the consequences of some accounting guidance. For example, certain guidance related to income taxes, consolidation, and equity (including financial instruments with characteristics of equity) may have different consequences for users of private company financial statements than for users of public company financial statements.

IV. Accounting Resources

DF10. Private companies generally have relatively fewer and less specialized accounting personnel than do public companies. Consequently, many private companies are less likely than public companies to actively participate in the standard-setting process and to closely monitor changes in accounting guidance. Because of their resource constraints, some private companies may find it more challenging than public companies to dedicate the time and resources necessary to evaluate and apply certain new standards. Some of the public accountants serving private companies are subject to the same limitations because of the smaller size of their firms. Although some large private companies have a depth of accounting resources similar to large public companies, the majority of private companies that prepare U.S. GAAP financial statements are small and have fewer accounting resources. Likewise, while large public accounting firms serve many private companies, smaller public accounting firms that have relatively fewer resources serve a large number of private companies.

Implications

DF11. The Board and the PCC should consider the resource constraints of private companies when developing effective date and transition guidance, as well as the timing and length of comment periods of Exposure Drafts. Those considerations also emphasize the continued need for (a) providing plain-English guidance, (b) exploring ways for private company stakeholders to meaningfully participate in the standard-setting process, (c) performing targeted outreach to private companies during the standard-setting process, and (d) conducting focused educational efforts following the issuance of new standards. Similar considerations also may be applicable to smaller public companies.

V. Learning about New Financial Reporting Guidance

DF12. Many preparers of private company financial statements said that they primarily learn about new financial accounting and reporting guidance from their public accountants and that those educational updates generally coincide with planning procedures for an audit, review, or compilation of year-end financial statements. Some of those preparers also stated that their public accountants frequently are not involved in the interim financial reporting process because their users rarely require a review or audit of interim financial reports. As a result, those preparers stated that they generally receive educational updates in the second half of the calendar year, and many receive significant educational updates once or twice a year. In contrast, because of the complexity of public company reporting requirements and their quarterly financial reporting requirements, preparers of public company financial statements commonly learn about new guidance, including by participating in web-based training, more continuously throughout the year. A large number of lenders and others that use private company financial statements and public accountants that serve private companies also must be educated to understand the effects of new guidance.

Implications

DF13. Private companies often require additional time to effectively and efficiently implement new guidance, and many private companies and/or their public accountants acquire valuable knowledge and achieve significant efficiencies from observing the earlier implementation experiences of public companies. Deferred effective dates for private companies help to ensure that preparers of their financial statements, and to some extent their public accountants, receive proper notification and training about new accounting and reporting guidance. Deferred effective dates also provide users of private company financial statements with additional time to learn about the new guidance and better assess how the change will affect the financial statements they use. Illustrative examples included in new guidance that apply to private companies should include common private company fact patterns.

Guide

1: Determining Recognition and Measurement Guidance

1.1 The purpose of this section of the Guide is to assist the Board and the PCC in evaluating whether and in what circumstances to provide recognition or measurement guidance for private companies that differs from the related guidance for public companies. However, the purpose of this section is not to reach conclusions about what the alternative method(s) of recognition or measurement should be for private companies. In selecting a recognition or measurement alternative within U.S. GAAP for private companies, the Board and the PCC should consider the benefits and costs of potential alternatives following due process that includes research, targeted outreach to stakeholders, and a public comment period. Many alternative methods to applying recognition and measurement guidance likely involve a corresponding modification to display or disclosure requirements.

1.2 In making the assessments in this module, the Board and the PCC first should determine whether the recognition or measurement guidance being evaluated provides relevant information to users of private company financial statements at a reasonable cost. That analysis should focus on (a) the relevance of the information in meeting the objective of financial reporting for typical users of private company financial statements, (b) the characteristics that differentiate users of private company financial statements from users of public company financial statements, and (c) the cost and complexity of applying the guidance.

1.3 If the guidance provides relevant information, the Board and the PCC should then consider whether the use of one or more practical expedients could satisfy the needs of users of private company financial statements while reducing the cost and complexity for preparers of those financial statements. The term *practical expedient* means a more cost-effective way of achieving the same or a similar accounting or reporting objective.

1.4 If the Board and the PCC determine that either (a) the information provided by the guidance is not relevant or (b) the information provided by the guidance is relevant but is overly costly or complex to provide and no practical expedient is available, they should proceed to analyzing the benefits and costs of potential alternative recognition or measurement methods for private companies. If a recognition or measurement difference for private companies increases the relevance of information to the primary users of private company financial statements, then the difference should be considered as long as the benefits justify any increase in costs.

Analyzing Benefits and Costs

1.5 In deciding whether to provide recognition or measurement alternatives for private companies within U.S. GAAP, the Board and the PCC should consider the questions listed in paragraphs 1.6 and 1.7. Some of the questions are most applicable when the Board and the PCC are reconsidering the benefits and costs of existing guidance, while other questions are most applicable when evaluating new guidance being deliberated for projects on the Board's current agenda. The questions included in paragraphs 1.6 and 1.7 are not all-inclusive, and the assessment of those benefits and costs requires judgment.

Relevance to users

1.6 The first group of questions pertains to the relevance of information to typical users of private company financial statements as follows:

- a. Does the transaction, event, or balance affect reported cash balances, cash flows, or adjusted EBITDA?
- b. Does the transaction, event, or balance significantly affect borrowings, liquidity, or leverage?
- c. Does the transaction or event affect, or does the balance relate to, trade receivables, inventories, fixed assets, other long-term tangible assets, accounts payable, or other liabilities?
- d. Do users typically consider the quantitative effect of the transaction, event, or balance when evaluating collateral, financial performance, or financial position? Consider whether users typically adjust financial statements by substituting an alternative accounting approach.
- e. Does the guidance require recognizing and measuring transactions for which uncertainty exists on the basis of the expected most likely outcome?
- f. Does the guidance relate to loss contingencies or commitments that could significantly affect future cash flows?
- g. Does the measurement guidance reflect volatility in financial statements resulting from underlying changes in market prices of debt instruments or certain derivatives that are expected to reverse contractually in the future because the entity has the intent and ability to hold the instrument or derivative to its defined maturity or term?

Cost and complexity

1.7 The second group of questions pertains to the cost and complexity of providing information to users of private company financial statements as follows:

- h. Does application of the guidance often require assistance from outside resources at a significant cost?
- i. Is significant complexity involved in determining or evaluating the initial and/or ongoing accounting treatment?
- j. Are there expected to be significant changes to information systems, contracts, internal controls, or processes as a result of applying the new guidance?
- k. Is the accounting treatment costly to audit, review, or compile?

Further considerations

1.8 In evaluating the responses to questions in paragraphs 1.6 and 1.7, the Board and the PCC should place more weight on the overall responses to questions relating to relevance to users (questions (a)–(g)). They generally should place a lesser, but significant, weight on the overall responses to questions relating to cost and complexity (questions (h)–(k)). *No* responses to questions (a)–(f) or *yes* responses to questions (g)–(k) would indicate that there may be a basis for the Board and the PCC to consider allowing alternative recognition or measurement guidance for private companies within U.S. GAAP. The responses to those questions should guide the Board and the PCC in determining whether and in what circumstances it may be appropriate to consider alternative recognition and/or measurement guidance for use by private companies. As explained in paragraph 1.1, following their due process, the Board and the PCC would then work to identify and evaluate potential alternatives that best address their objective.

1.9 The Board and the PCC should not provide alternatives (beyond practical expedients) for private companies when recognizing or measuring the type of information on which typical users of private company financial statements commonly focus. No alternatives within U.S. GAAP should be considered unless input from users indicates that a difference or change is appropriate. In evaluating potential alternatives for private companies within U.S. GAAP, the Board and the PCC should consider the cost of providing the information—both in terms of the cost incurred to prepare the information and the efforts that users may spend to adjust financial statements—by substituting an alternative accounting method that may produce a result that users consider more relevant.

1.10 As the Board and the PCC evaluate potential alternatives for private companies within U.S. GAAP, they also should consider the ability of users of private company financial statements to access management to obtain additional information beyond what is reported in financial statements. Access to management should be viewed as a mitigating factor in evaluating cost-benefit considerations, including the risk that some users might find public company recognition or measurement guidance to be more relevant. If the Board and the PCC limit alternatives for private companies to those areas of U.S. GAAP that do not have broad or significant relevance to typical users of private company

financial statements, relatively few users are expected to need access to management to obtain additional information relating to transactions or events for which an alternative method has been applied.

1.11 Generally, a private company could select the alternatives within recognition or measurement guidance that it deems appropriate to apply without having to apply all alternatives within recognition and measurement for private companies. However, the Board and the PCC may require application of certain alternatives within recognition or measurement in one area to be linked to the application in another area. A private company that applies alternatives within recognition or measurement guidance should disclose that fact in the notes to financial statements to help users of its financial statements understand that one or more areas of the company's financial statements are not presented on a comparable basis with those of public companies or other private companies that elected not to apply the alternatives within U.S. GAAP.

Industry-Specific Guidance

1.12 When the Board and the PCC consider whether an alternative for private companies should be made within recognition and measurement guidance, they should determine whether the alternative would amend any industry-specific accounting guidance for private companies in Topics 905 through 995 of the *FASB Accounting Standards Codification*[®] (industry Topics). The determination of whether an alternative should be made within recognition and measurement guidance for industry Topics should be similar to the consideration of non-industry-specific guidance. That is, that determination would need to be made on the basis of the relevance of the industry-specific information to meeting the objective of financial reporting for users of private company financial statements and the cost and complexity of providing that information. Regardless of other factors that differentiate private companies from public companies, some recognition and measurement guidance could be equally relevant to users of public company and private company financial statements because of the unique nature of certain industries and the often specialized accounting guidance that companies in those industries are required to apply and because of the potential demand for greater comparability between private company and public company financial statements in regulated or highly specialized industries.

1.13 When the Board issues broad or objectives-based accounting guidance for which no industry-specific guidance is provided, the Board and the PCC would have to determine whether certain industries should be excluded from the scope when considering particular alternatives for private companies within U.S. GAAP. That determination would be made on the basis of the relevance of the financial information to the financial statement users of private companies and public companies that have core operations in those industries and the cost and complexity of providing that information.

2: Determining Disclosure Requirements

2.1 In assessing whether to provide disclosure alternatives for private companies within U.S. GAAP, the Board and the PCC first should determine whether the disclosure provides relevant information to the most common types of users of private company financial statements. If the Board and the PCC determine that a disclosure provides relevant information to typical users of private company financial statements at a reasonable cost, generally no disclosure alternatives within U.S. GAAP should be considered.

2.2 The determination of whether an alternative should be provided for industry-specific disclosures should be similar to the consideration of non-industry-specific disclosures. That determination would need to be made on the basis of the relevance of industry-specific disclosures to users of private company financial statements and the cost and complexity of providing those disclosures. In assessing the relevance of industry-specific disclosures, the Board and the PCC should consider the unique nature of certain industries and the often specialized disclosures that companies in those industries are required to apply because of the potential need for greater comparability between private company and public company financial statements in regulated or highly specialized industries.

2.3 In deciding whether to provide disclosure alternatives for private companies within U.S. GAAP, the Board and the PCC should consider the following:

- a. The typical needs and areas of focus of lenders, other creditors, and investors that use private company financial statements
- b. The relevance of the measurement attribute required by the current guidance to typical users of private company financial statements
- c. The existing knowledge and familiarity that many users of private company financial statements typically have about the reporting entity
- d. The general ability of users to obtain additional information directly from preparers of private company financial statements throughout the reporting period and afterward
- e. Given the resource constraints of many private companies, the cost of preparing, auditing, reviewing, or compiling the information to be disclosed
- f. Whether the relevance of a disclosure is significantly reduced by the lag between the year-end reporting date and the date that financial statements are issued and made available to users
- g. The concern of preparers of private company financial statements about disclosing proprietary information.

2.4 In assessing the factors in paragraph 2.3, the Board and the PCC should place the most weight on factors related to the relevance of the disclosure to the most common types of users of private company financial statements (factors (a)

and (b)). The Board and the PCC generally should not provide disclosure alternatives related to information on which typical users of private company financial statements commonly focus (see paragraph 2.8).

2.5 As the Board and the PCC evaluate potential disclosure alternatives, they should consider the ability of private company financial statement users to directly access management to obtain additional information beyond what is included in financial statements (factors (c) and (d) in paragraph 2.3). However, generally no disclosure alternatives should be permitted unless input from users indicates that a disclosure either does not provide relevant information to typical users of private company financial statements or provides information that is of limited relevance to a narrow set of those users. Management access should not be considered a dominant factor in deciding whether to permit a disclosure alternative. Rather, management access should be considered as a mitigating factor in evaluating cost-benefit considerations, including the risk that a limited number of users might find a particular disclosure to be relevant. Many users of private company financial statements indicated that they use the notes to financial statements as a secondary source of information to validate previous knowledge and expectations and to potentially engage in a more focused dialogue with management in what can be described as a red-flag approach to review (see paragraphs BC39 and BC40). In evaluating disclosure alternatives for private companies, the Board and the PCC should consider whether there will be sufficient disclosure in the notes necessary to facilitate a user's review and to allow a user to identify appropriate follow-up questions for management when the user deems it necessary to do so.

2.6 In evaluating potential disclosure alternatives for private companies within U.S. GAAP, the Board and the PCC also should consider, but place less weight on, the cost of providing the disclosures, both in terms of the cost incurred by the preparer and the efforts spent by the user to sort through disclosures that may have limited or no relevance (factor (e) in paragraph 2.3). The Board and the PCC also should consider, but place the least amount of weight on, the typical timing of the availability of private company financial statements and the risk that a disclosure may result in the sharing of proprietary information (factors (f) and (g) in paragraph 2.3).

2.7 Because many users of private company financial statements do not seek the same level of detailed information as do users of public company financial statements and because of cost considerations, the Board and the PCC generally should consider not requiring the disclosure of disaggregated information such as the following:

- a. A tabular reconciliation of the beginning and ending balances of balance sheet accounts, even if the reconciliation provides information that relates to areas included in paragraph 2.8
- b. Quantitative details about the composition of certain income statement or balance sheet line items.

If the Board and the PCC determine that the disclosure of additional disaggregated information, including tabular account reconciliations, would be relevant to typical users of private company financial statements, they generally should provide disclosure alternatives that limit the requirement to a nontabular description or, in other words, a narrative (which may include both quantitative and qualitative information) that can provide users with a basic understanding of items having the most significant effect on financial statements.

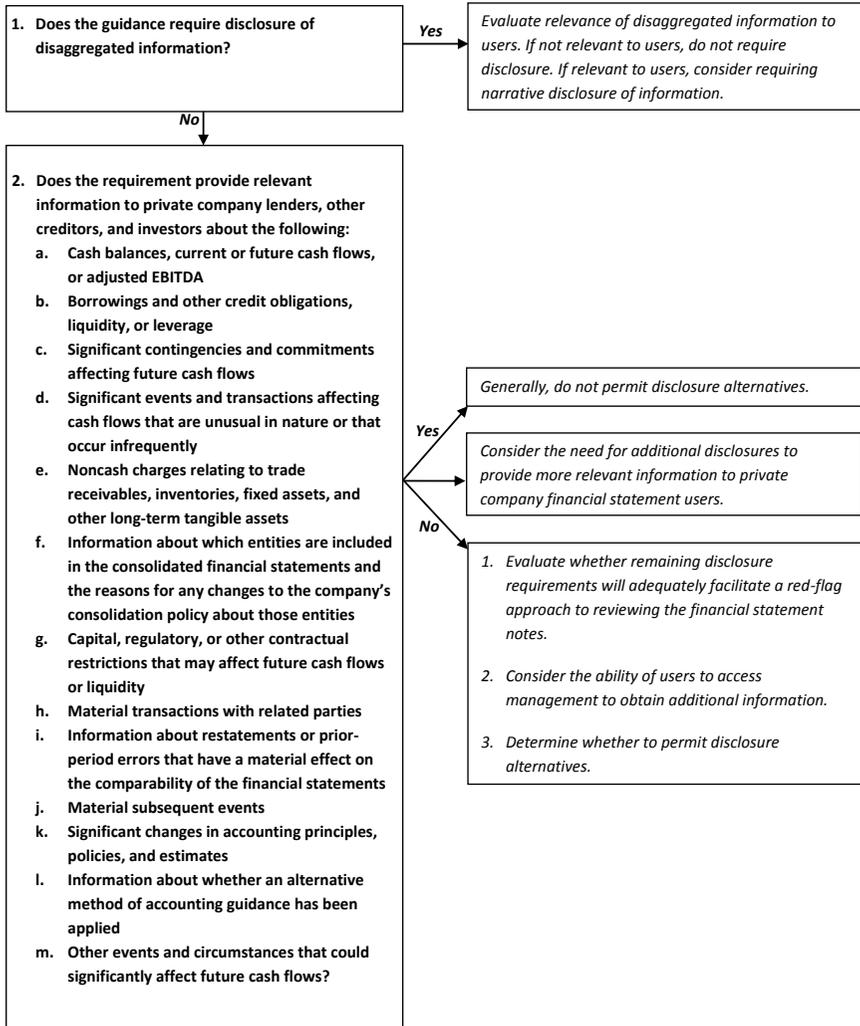
2.8 The following list describes common areas of focus of typical users of private company financial statements. The Board and the PCC generally should not provide disclosure alternatives within U.S. GAAP relating to the following:

- a. Cash balances, current or future cash flows, or adjusted EBITDA
- b. Borrowings and other credit obligations, liquidity, or leverage
- c. Significant contingencies and commitments affecting future cash flows
- d. Significant events and transactions affecting cash flows that are unusual in nature or that occur infrequently
- e. Noncash charges relating to trade receivables, inventories, fixed assets, and other long-term tangible assets
- f. Information about which entities are included in the consolidated financial statements and the reasons for any changes to the company's policy about which entities are included in the consolidated financial statements
- g. Capital, regulatory, or other contractual restrictions that may affect future cash flows or liquidity
- h. Material transactions with related parties
- i. Information about restatements or prior-period errors that have a material effect on the comparability of financial statements
- j. Material subsequent events
- k. Significant changes in accounting principles, policies, and estimates
- l. Information about whether an alternative method of accounting guidance has been applied
- m. Other events and circumstances that could significantly affect future cash flows.

2.9 In light of the typical information needs of users of private company financial statements, the Board and the PCC also should consider whether private companies should provide additional disclosures beyond those required by public companies or whether modified disclosures would provide more relevant information to typical users of private company financial statements. Additional or modified disclosures are warranted as long as the benefits justify any increase in costs. Examples might include information about the timing and amount of distributions paid to owners, related party relationships, and income tax sharing arrangements.

Illustration—Process Flowchart

2.10 The flowchart below illustrates the steps to use when deciding whether to permit disclosure alternatives for private companies within U.S. GAAP.



3: Determining Display Requirements

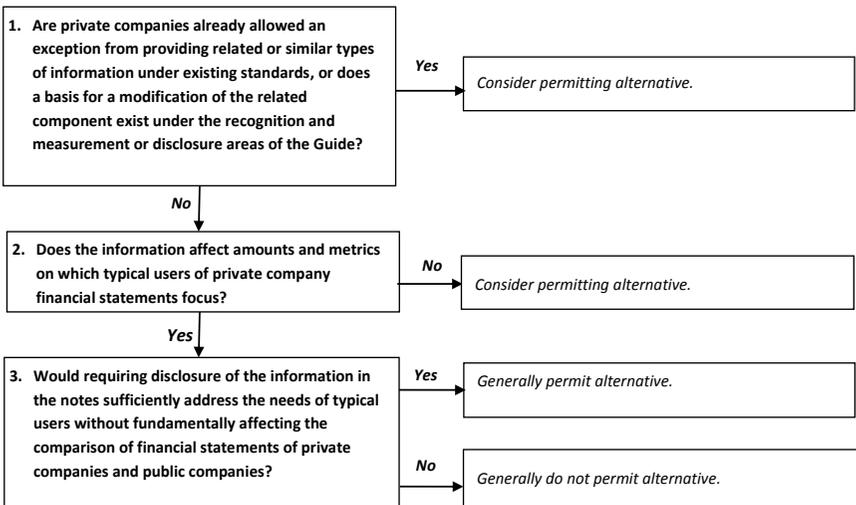
3.1 Generally, both private companies and public companies should apply the same financial statement display (the term *display* is synonymous with the term *presentation*) guidance established by the Board because of the presumption that information that is important enough to be presented on the face of financial statements is relevant to most financial statement users. However, in some circumstances, the Board and the PCC may conclude that private companies should be permitted to apply alternative display requirements. In determining whether to permit a display alternative, the Board and the PCC should assess, among other pertinent considerations, whether the information to be displayed is not relevant to typical users of private company financial statements or does not apply to private companies or whether disclosing the disaggregated or supplemental information about financial statement line items in the accompanying notes would sufficiently address the needs of typical users without fundamentally affecting the comparison of financial statements of private companies and public companies.

3.2 In determining whether information is not applicable or relevant to typical private company users, the Board and the PCC should consider, among other factors, the following:

- a. Whether private companies already are permitted an exception from providing related or similar types of information, for example, earnings per share and segment information, under existing guidance
- b. Whether there is a basis to support alternative recognition and measurement or alternative disclosure requirements of the related financial statement components
- c. Whether the information affects amounts and metrics on which typical users of private company financial statements focus (see paragraph 2.8).

Illustration—Process Flowchart

3.3 Generally, there is a presumption that both private companies and public companies should apply the same financial statement display guidance established by the Board, as discussed in paragraph 3.1. The flowchart below illustrates the steps to use when determining whether that presumption should be rebutted.



4: Determining the Effective Date of Guidance

4.1 Because of private companies' resource limitations and the learning cycle discussed in paragraphs DF10–DF13, generally, the amendments in a FASB Accounting Standards Update should be effective for private companies one year after the first annual period for which public companies are required to adopt them.

4.2 Generally, amendments for private companies should be effective first for annual periods and then for interim periods thereafter. Private companies generally should not be required to adopt amendments during an interim period within the initial fiscal year of adoption.

4.3 In determining whether the effective date for private companies should be the same as the first annual period required for public companies, the Board and the PCC should consider whether there is an immediate need for the amendments to become effective. In making that determination, the Board and the PCC should consider whether the amendments are being issued to (a) correct or clarify existing guidance that results in significant diversity in practice or confusion among users of financial statements or (b) address an emerging issue or regulatory change such as a change in tax law or the establishment of a new government program or fee.

4.4 In determining whether the effective date for private companies should be more than one year after the first annual period required for public companies, the Board and the PCC should consider (a) the complexity of and the extent of change expected from the amendments, (b) whether the amendments are required to be applied using a retrospective method of transition, and (c) the extent to which users may be adversely affected as a result of an extended period of time in which private company and public company financial statements are not reported on a comparable basis. An extended period of noncomparability would be an even more important consideration when the amendments affect reported cash balances, cash flows, adjusted EBITDA, working capital, total borrowings, or liquidity and leverage metrics.

4.5 In assessing the complexity of the amendments, the Board and the PCC should evaluate the following:

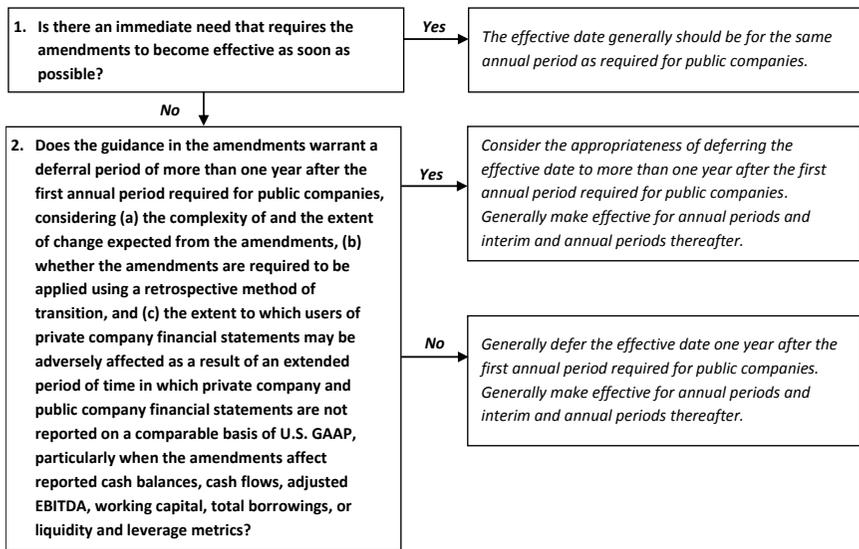
- a. The extent and magnitude of the expected change to financial statements, including the effect on users and preparers of private company financial statements
- b. The anticipated effort needed to implement the amendments, including the extent of changes to information systems, the expected level of reliance on third-party consultants and specialists for implementation assistance, and the magnitude of potential changes to internal controls and processes
- c. The anticipated effect of the amendments on the terms of contractual agreements, including loan and credit agreements and related

covenants, customer and supplier contracts, compensation and labor agreements, and regulatory requirements.

4.6 Generally, private companies should be permitted to adopt the amendments before the deferred effective date for private companies, but no earlier than the required or permitted effective date for public companies.

Illustration—Process Flowchart

4.7 The flowchart below illustrates the steps to use when evaluating the effective date of amendments for private companies.



5: Determining the Transition Method for Applying Guidance

5.1 If public companies are required to apply the amendments in an FASB Accounting Standards Update using either the full retrospective method¹ or a modified retrospective method² of transition, the Board and the PCC should consider whether the same method of retrospective transition is appropriate for private companies. The Board and the PCC should first assess whether a practical expedient is available. Even if the Board has provided public companies with one or more practical expedients for applying a retrospective method, the Board and the PCC should evaluate whether a basis exists to permit one or more additional practical expedients for private companies.

5.2 After evaluating the availability of practical expedients, the Board and the PCC should consider whether there is a sufficient basis to allow private companies to apply a modified retrospective method (if public companies are required to apply the full retrospective method). After evaluating practical expedients and the benefits and costs of modified retrospective method alternatives, the Board and the PCC should assess whether they should require or permit the prospective method of transition for private companies.

5.3 A private company should be required to disclose in the notes to financial statements the fact that it has applied an alternative transition method. That disclosure should include, at a minimum, qualitative information about how the amendments affect the comparison of its current-period financial statements with its prior-period financial statements. In limited circumstances, the Board and the PCC should consider whether a private company also should disclose quantitative information about how the amendments affect the comparison of its current-period financial statements with its prior-period financial statements.

¹The term *full retrospective method* is used in this Guide with the same meaning as the term *retrospective application* in Topic 250, Accounting Changes and Error Corrections. Topic 250 defines retrospective application as:

The application of a different accounting principle to one or more previously issued financial statements, or to the statement of financial position at the beginning of the current period, as if that principle had always been used, or a change to financial statements of prior accounting periods to present the financial statements of a new reporting entity as if it had existed in those prior years.

²The term *modified retrospective method* used in this Guide refers to any variation of the full retrospective method. For example, a combination of the following is considered to be a modified retrospective method of transition:

- a. An approach that requires the recognition of the cumulative effect of initially applying the new accounting principle as an adjustment to the opening balance of retained earnings for the initial year of adoption but does not require prior periods to be restated under a new accounting principle.
- b. Applying the new accounting principle to all transactions in the initial year of adoption under the new accounting principle.

Consideration of quantitative disclosures should be limited to amendments that significantly affect important financial metrics as listed in paragraph 5.4(a) and (b).

5.4 In determining whether a sufficient basis exists to permit an alternative transition method for private companies, the Board and the PCC should consider the following questions:

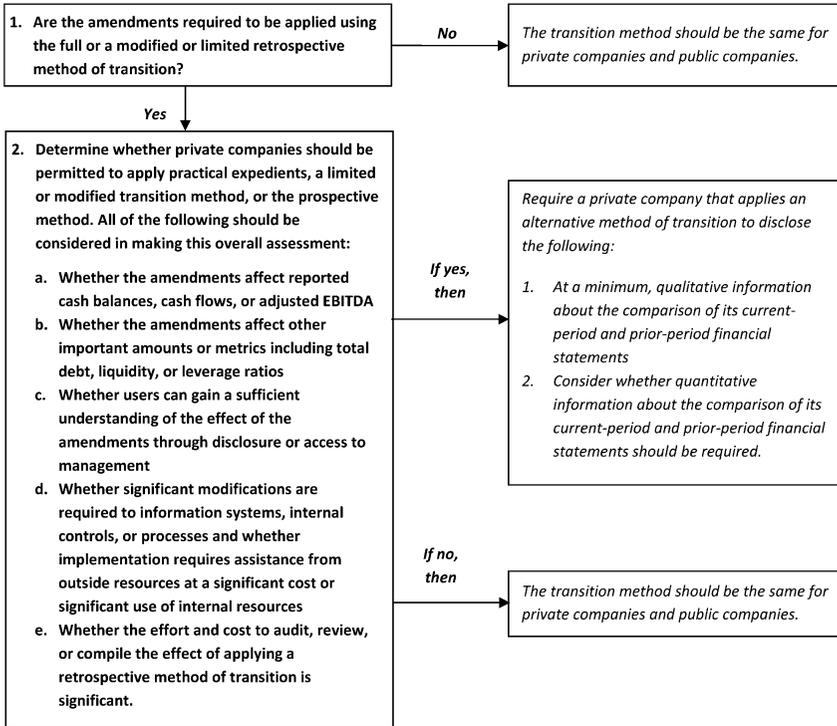
- a. Do the amendments affect reported cash balances, cash flows, or adjusted EBITDA?
- b. Do the amendments affect the comparability of other important amounts or metrics used by many private company financial statement users, including total debt, liquidity, or leverage ratios?
- c. Would the disclosures described in paragraph 5.3 likely satisfy the needs of typical users to obtain a sufficient understanding about the effect of the amendments on the comparative reporting period? If not, could users that are interested in understanding the effect of retrospectively applying the amendments likely obtain information directly from management that would reasonably satisfy their needs?
- d. Would applying a retrospective method of transition require significant modifications to (1) information systems, (2) internal controls, or (3) processes? In addition, would applying a retrospective method of transition require implementation assistance from outside resources at a significant cost, or significant use, of internal resources?
- e. Would the effort and costs to audit, review, or compile the effect of applying a retrospective method of transition be significant?

5.5 In evaluating the responses to the questions in paragraph 5.4, the Board and the PCC should place more weight on the responses to the questions related to user relevance (questions (a)–(c)) and lesser weight on the responses to the questions related to cost and complexity (questions (d) and (e)). *No* responses to questions (a) or (b) or *yes* responses to questions (c)–(e) would indicate that there may be a basis for the Board and the PCC to consider allowing alternative transition methods.

5.6 In analyzing the benefits and costs of permitting an alternative transition method, the Board and the PCC should consider (a) the limited distribution of private company financial statements, (b) the typical manner in which private company financial statements are used, (c) the level of access to management and the relationships that commonly exist between financial statement preparers and the users of their financial statements, and (d) the typical level of accounting resources at most private companies. Given those factors, the benefits of applying a retrospective method of transition to achieve comparability between private company financial statements and public company financial statements and to evaluate trends sometimes may not justify the related costs of reporting that information.

Illustration—Process Flowchart

5.7 The flowchart below illustrates the steps to use when determining the method of transition for private companies.



This Guide was adopted by the affirmative vote of five members of the Financial Accounting Standards Board. Mr. Smith dissented and Mr. Kroeker abstained from voting.

Mr. Smith dissented from this Guide because he does not believe the Guide accomplishes its primary purpose.

The primary purpose of the Guide is to assist the Board and the PCC in determining whether and in what circumstances the Board should provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under U.S. GAAP. Mr. Smith does not believe the Guide accomplishes that purpose because he does not believe the factors identified to differentiate the financial reporting considerations of private and public companies are, in some cases appropriate, and in other cases, effective in highlighting where differences may be appropriate.

The Guide identifies five significant factors that differentiate the financial reporting considerations of private companies from those of public companies. Mr. Smith believes the Guide includes broad generalizations about many of those factors, which has caused the Board to underemphasize one of the fundamental tenets included in Chapter 1 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1*, The Objective of General Purpose Financial Reporting, and *Chapter 3*, Qualitative Characteristics of Useful Financial Information:

The objective of *general purpose* [emphasis added] financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. [Paragraph OB2; footnote reference omitted.]

The Board's conceptual framework was designed to assist the Board in developing standards for general purpose financial statements. The FASB *Rules of Procedure* and paragraph OB5 of Concepts Statement 8 specifically acknowledge that many investors, lenders, and other creditors cannot require reporting entities to provide information directly to them and that they, as the primary users of financial statements prepared in accordance with U.S. GAAP, must rely on general purpose financial statements. Mr. Smith believes that many of the differentiating factors included in the Guide fail to acknowledge that preparers can choose not to provide information requested of them. Consequently, he believes that application of the alternatives developed by following the Guide will not result in financial statements that are general purpose financial statements.

The Guide identifies *access to management* as a significant factor that differentiates financial reporting considerations of private and public companies. To assume user access to management is in direct conflict with the notion of general purpose financial statements and, as acknowledged in paragraph DF3 of this Guide, at one end of the extreme it would seem to indicate that financial statements are unnecessary. The underlying premise of the concept of general purpose financial statements is that users do not have access to management. There is no assurance that all users will have access to management; therefore, Mr. Smith is concerned that decisions about U.S. GAAP requirements that are based on the concept of access to management will result in incomplete financial reporting, thereby depriving users who are not granted access to management with important financial information. Taken to the extreme, providing no financial information whatsoever could be viewed as complying with the Guide on the basis of the notion that a user can always ask management for whatever information the user deems relevant to decision making. Said another way, consideration of access to management as a basis for establishing alternatives for private companies would seem to obviate the need for any form of GAAP directed toward private companies because they don't need general purpose financial statements.

Mr. Smith believes the decision on whether to consider alternatives for private companies should be on the basis of the relevance of the issue in meeting the objectives of financial reporting, which is "to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity." He notes, however, that if the concept of relevance was used to identify potential alternatives, there would be few issues for which alternatives would be considered, since the fundamental focus of all users of both private company and public company financial statements is the same, that is, to make "decisions about providing resources to the entity" by assessing the prospects for future net cash inflows to an entity.

Mr. Smith notes that paragraph 1.6 of the Guide poses a series of questions to identify transactions or circumstances that typically would be relevant to users of private company financial statements. Mr. Smith does not believe those questions will be particularly helpful in identifying transactions or circumstances that are unique to private companies, since the responses to them would generally indicate that the same transactions or circumstances would be relevant to users of public company financial statements as well.

The Guide indicates that a differentiating factor is the number of primary users of a private company's financial statements, not the types of users. Mr. Smith believes the broad generalization that there are fewer users of private company financial statements is troubling, since there are clearly very large private companies whose financial statements are used by considerably more users than many public companies. More important though, how does the number of

users influence whether a financial reporting matter is relevant or not? Mr. Smith does not understand how the number-of-financial-statement-users factor will be helpful to the PCC and Board members in evaluating alternatives for meeting the objective of financial reporting. There is no guidance in this Guide for making that assessment. Rather, the implication included in the Guide is that the small size of the private company user population makes it easier for all users to access management to obtain information.

Mr. Smith has similar concerns with some of the generalizations made in describing the other factors included in the Guide. For example, the factor on investment strategies of primary users explains that equity investors of private companies hold their investments for the long term, while equity investors of public companies are likely to hold their equity ownership interests for shorter durations. Mr. Smith is unaware of any evidence to support this assertion other than anecdotal evidence supplied by various constituents. Notwithstanding, even if there is some truth in that assertion, clearly there are owners of equity interests in private companies who do not hold their interests for long durations and there are owners of equity interests in public companies who hold their interests for years. Mr. Smith notes that in the discussion of the implication of this differentiating factor (assuming one accepts it as important) there is a general acknowledgment that the focus of many holders of equity interests, regardless of whether those interests are in public or privately held companies, is the same; that is, they are interested in accounting guidance that is useful in assessing potential future cash flows from providing their investment.

Paragraph OB3 of Concepts Statement 8 notes the following:

Investors', lenders', and other creditors' expectations about returns depend on their assessment of the amount, timing, and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors, lenders, and other creditors need information to help them assess the prospects for future net cash inflows to an entity.

Users have a fundamental interest in financial information that is useful in assessing the prospects for future cash flows regardless of whether they are reviewing financial information of a private entity or a public entity. Yet, the Guide highlights cash flows and cash-adjusted earnings as being a differentiating factor for users of private company financial statements. This view is fundamentally false. Mr. Smith believes that the prominence of the discussion in paragraphs OB3 and OB4 of Concepts Statement 8 illustrates the importance of evaluating the amount, timing, and uncertainty of future cash flows to the objective of financial reporting. All equity investors (as well as other resource providers) are interested in that assessment; consequently, Mr. Smith fails to see how the investment strategy of equity owners (or any other resource provider for that matter), even if one accepts that there are significant differences (which Mr.

Smith does not accept), will be useful in identifying alternatives that are distinctly relevant to achieving the objective of financial reporting for private companies.

Ownership and capital structure also are identified as a differentiating factor. Specifically, the Guide indicates that a large number of private companies are structured as pass-through entities and that common private company ownership structures include S corporations; limited liability companies; general, limited, limited liability, or family limited partnerships; sole proprietorships; and trusts. Yet, the Guide provides no basis for why these different structures influence, or should influence, financial reporting to achieve the objective of financial reporting. Certain areas of accounting are identified in the Guide as being important to those various structures, such as income taxes, consolidation policy, and equity. Mr. Smith believes that when material, these areas are equally relevant to both private companies and public companies and does not understand the Guide's assertion that these areas may have "different" relevance for private companies. Quite frankly, other than degrees of relevance, Mr. Smith does not understand the types of qualitative differences in relevance that may exist. Furthermore, the Guide provides no guidance on how to assess any differences that may exist.

Mr. Smith acknowledges that two factors identified in the Guide—accounting resources and learning about new financial reporting guidance—are factors that may be useful in evaluating effective dates and possibly transition methods for private companies. However, Mr. Smith again asserts that the Guide has made some fairly broad generalizations; after all, smaller public companies may very well share some of the characteristics of private companies in those areas. At the same time, there are a considerable number of highly talented individuals who closely monitor standard-setting activities that work at privately held companies and their audit firms. Nevertheless, Mr. Smith accepts accounting resources and learning about new financial reporting guidance as appropriate differentiating factors for assessing effective dates and transition guidance for private companies.

In conclusion, Mr. Smith does not believe the Guide provides the PCC and the Board with guidance that will be helpful in identifying alternatives that should be available to private companies reporting under U.S. GAAP. That being said, Mr. Smith acknowledges the complexity of U.S. GAAP and, therefore, believes that the PCC and the Board need to increase their efforts in identifying areas in which financial reporting can be simplified without sacrificing information relevant to meeting the objective of financial reporting. In other words, Mr. Smith believes that the Board needs to identify simpler ways of providing information that is relevant to meeting the objective of financial reporting in a less costly manner to the benefit of both public and private company financial statement users.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

This Guide was adopted by the unanimous vote of the 10 members of the Private Company Council:

Billy M. Atkinson, *Chairman*
George W. Beckwith
Steven J. Brown
Jeffery C. Bryan
Mark S. Ellis
Thomas J. Groskopf
Neville Grusd
Carleton L. Olmanson
Diane M. Rubin
Lawrence E. Weinstock

Appendix: Basis for Conclusions

Introduction

BC1. The purpose of this Guide is to provide the Board and the PCC with factors to consider in determining whether and in what circumstances to provide alternatives for private companies within U.S. GAAP with respect to recognition, measurement, disclosure, display, effective date, and transition requirements.

BC2. Paragraph OB2 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information*, states the following:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. [Footnote reference omitted.]

This Guide provides considerations for the PCC and the Board in making user-relevance and cost-benefit evaluations for private companies under the existing conceptual framework. The Guide is intended to be a tool to help the Board and the PCC identify differential information needs of users of public company financial statements and users of private company financial statements and to identify opportunities to reduce the complexity and costs of preparing financial statements in accordance with U.S. GAAP. Even if an alternative within financial reporting is permitted for private companies, a private company could decide not to apply it (for example, a private company planning an initial public offering of stock). Likewise, users may not accept financial statements that reflect alternatives for private companies within U.S. GAAP.

All-or-Nothing Approach of Applying Alternatives within Recognition and Measurement Guidance

BC3. Some users of private company financial statements stated that they prefer an all-or-nothing approach of applying recognition and measurement alternatives within U.S. GAAP to achieve consistency within a private company's financial statements and to promote comparability among the financial statements of private companies that choose to apply the recognition and measurement alternatives provided as a result of applying this Guide. Those users indicated that such an approach would reduce the confusion that they may experience if private companies are allowed to select which alternatives within U.S. GAAP they deem appropriate to apply. The users acknowledged that the extent of that confusion will depend on the number of recognition and

measurement alternatives that ultimately are permitted and the nature of those alternatives.

BC4. Most preparers of private company financial statements acknowledged the concerns of those users but stated that preparers should be permitted to select the alternatives for private companies within recognition or measurement that they deem appropriate to apply. Those preparers pointed to the possibility that not every permitted alternative within recognition or measurement guidance may provide the most relevant information to users of their financial statements or for the companies operating in their industry. Some stakeholders also stated that the goal of this Guide is to permit private companies to provide relevant information to users of their financial statements and, thus, the companies should be permitted to choose which alternatives for private companies they think are most relevant to their user base. Some preparers also shared concerns about being required to make an initial commitment to apply all future alternatives for private companies within U.S. GAAP that are permitted as a result of using this Guide without knowing the nature or volume of the recognition and measurement alternatives that the Board and the PCC may ultimately provide.

BC5. The Board and the PCC decided that, generally, a private company should be permitted to select the alternatives within recognition or measurement guidance that it deems appropriate to apply. However, the Board and the PCC may require certain related alternatives to be elected as a group.

1: Determining Recognition and Measurement Guidance

BC6. This appendix explains the underlying reasons for the views in this Guide for private company decision making, beginning with why the Board and the PCC should address the questions listed in paragraphs 1.6 and 1.7. That explanation highlights the differences between users of private company financial statements and users of public company financial statements. The discussion also identifies preparer considerations that the Board and the PCC should take into account in analyzing the benefits and costs of recognition and measurement guidance for private companies. The explanations reflect input received from a significant number of stakeholders about their experiences using, preparing, auditing, reviewing, and compiling private company financial statements and their perspectives about the factors that differentiate the financial reporting considerations of private companies and public companies.

BC7. This appendix also explains how the Board and the PCC should evaluate and prioritize different considerations and stakeholder needs by emphasizing that it is most important to focus on providing relevant information to financial statement users. This appendix explains that the Board and the PCC should place a significant, albeit lesser, focus on considerations about the cost and complexity of providing that relevant information.

BC8. For the convenience of readers, this appendix repeats the questions from paragraphs 1.6 on relevance and 1.7 on cost and complexity.

Relevance to Users

- a. **Does the transaction, event, or balance affect reported cash balances, cash flows, or adjusted EBITDA?**
- b. **Does the transaction, event, or balance significantly affect borrowings, liquidity, or leverage?**
- c. **Does the transaction or event affect, or does the balance relate to, trade receivables, inventories, fixed assets, other long-term tangible assets, accounts payable, or other liabilities?**
- d. **Do users typically consider the quantitative effect of the transaction, event, or balance when evaluating collateral, financial performance, or financial position? Consider whether users typically adjust financial statements by substituting an alternative accounting approach.**

BC9. The most common users of private company financial statements are investors, lenders, and other creditors, such as sureties. For purposes of this Guide, the term *investors* refers to equity investors. While debt investors also may use private company financial statements, their needs are more closely aligned with the needs of lenders and other creditors.

BC10. Vendors, customers, lessors, insurers, regulators, and trustees of employee stock ownership plans also use private company financial statements. While those types of users also often focus on cash flows, liquidity, and solvency, it is important to emphasize the needs of investors, lenders, and other creditors—the primary users of private company financial statements—in evaluating the relevance and costs of recognition and measurement guidance for private companies. If private company financial statements do not contain information sufficient to satisfy the needs of nonprimary users, there are no restrictions on management’s ability to directly provide those users with additional information outside of financial statements.

BC11. Lenders are most concerned about financial statement transactions that affect cash flow from operations available to service debt to help them assess their ability to collect the principal loaned to a borrower when it becomes due, along with the scheduled interest payments. Lenders and other creditors also are concerned about total borrowings and other contingencies and commitments that may affect liquidity, solvency, and future cash flows. When assessing the earnings of a private company that is not a financial institution, typical users often focus on adjusted EBITDA. In contrast, most users of the financial statements of privately held financial institutions do not focus on the statement of cash flows

and adjusted EBITDA. Many users of private company financial statements indicated that they do not focus on fair value measurements of debt instruments and certain derivatives and the related effect of changes in fair value measurements on reported earnings and financial position resulting from changes in market prices that are expected to reverse contractually in the future. Private company financial statement users commonly focus on fair value measurements (a) in the limited number of industries for which fair value is the primary measurement attribute, such as investment companies, (b) for equity instruments when a quoted market price is available, and (c) when a company does not intend to hold a debt instrument or derivative until its maturity or term.

BC12. As discussed in paragraphs DF6 and DF7, the investment strategies of primary users in private companies and investors in public companies often differ, including the length of time that investments generally are held and the expected sources of investment returns. Those differences affect the importance that investors in private companies and investors in public companies place on financial statement amounts. For example, transactions that affect cash flows and adjusted EBITDA are of primary importance to investors in private companies because of their focus on cash dividends and other cash distributions as the source of their investment returns. Investors in public companies also focus on cash transactions and balances, but generally their needs for financial information are broader and more diverse than those of investors in private companies and many use information in U.S. GAAP financial statements for different reasons.

BC13. Because of lenders' focus on cash and liquidity, debt covenant calculations typically exclude many noncash transactions, particularly those of a nonoperating nature. Many private company investors in nonfinancial institutions also adjust EBITDA to eliminate the effect of some additional noncash transactions such as unrealized gains or losses and impairment losses to better reflect cash flows. Those analyses typically do not eliminate noncash transactions that result from applying the accrual basis of accounting, such as establishing liabilities for payroll and warranty expense. Many preparers of private company financial statements said that the preparation efforts and audit or review costs of complying with some accounting guidance that does not affect reported cash amounts or liquidity often are not justified considering the limited benefits of reporting that information to users.

BC14. In addition to cash and cash flow from operations available to service debt, lenders focus on a borrower's tangible net worth that is eligible to support a loan. Therefore, lenders evaluate accounts such as trade receivables, inventories, fixed assets, accounts payable, and other liabilities, but they most often exclude goodwill and other intangible assets from their quantitative analyses. Secured lenders commonly require a borrowing base certificate that lists the receivables and inventories that are eligible for collateral financing. As a result, lenders generally are interested most in the types of noncash adjustments that affect working capital accounts that serve as collateral against which they

can lend on a loan-to-value basis, such as bad-debt charges and inventory obsolescence losses; fixed assets and other long-term tangible assets that serve as collateral; and accrued operating expenses and other charges affecting earnings that relate to the entity's core operations. Lenders also focus on incremental working capital and the level of fixed asset investment required to achieve forecasted revenue. However, many lenders said that they typically receive a much greater level of detail about those accounts directly from management on a monthly or quarterly basis than what is included in U.S. GAAP financial statements.

BC15. While historical cost may not be a relevant measurement basis for a lender to assess tangible collateral, most lenders focus on liquidation value, which may not always be equivalent to fair value, and they often engage their own valuation professionals to perform independent appraisals. Similarly, historical cost or amortized cost may not be the most relevant measurement basis for an investor to assess the value of its investment. However, many private company investors also will engage a valuation professional when they deem it appropriate and relevant (for example, when contemplating selling their ownership interest) rather than rely on recurring fair value measurements included in U.S. GAAP financial statements. For those reasons, many private company stakeholders said that the costs of providing some fair value measurements on a recurring basis, in particular, when quoted market prices do not exist, often are not justified by the related benefits.

BC16. Most lenders prefer to receive a borrower's financial information presented on the basis of primary or direct responsibility for repaying the loan, which is a legal entity basis. Many lenders said that combining the net assets and cash flows of the legal entity with which they entered into a borrowing agreement with those of another legal entity distorts the tangible net asset and cash flow positions of the legal entity that are available to repay the borrowing. Many private company investors also focus on the legal entity because owners' income tax, estate tax, and succession planning typically are based on the legal structure of the entity and because some investors provide personal guarantees of the legal entity's performance under loan and other credit agreements. Investors also may focus on the legal entity if they do not have a direct ownership interest in a consolidated variable interest entity. In contrast, some sureties and other types of users are interested in the financial performance and position of the consolidated reporting entity because they need to assess the company's overall solvency and ability to continue as a going concern. However, most sureties and some lenders said that they prefer to receive *consolidating* financial statements rather than *consolidated* financial statements to better understand the composition of the entity's financial results and position. Many times, those sureties and lenders are willing to accept an unaudited consolidating presentation prepared by management.

BC17. The factors discussed above support the recommendation that the Board and the PCC should consider whether lenders and other creditors or investors

commonly disregard the quantitative effect of applying particular recognition or measurement guidance in evaluating the relevance of the resulting information for users of financial statements. The Board and the PCC also should consider whether lenders commonly accept financial statements with a qualified accountant's report because of modifications to existing recognition or measurement guidance (that is, intentional modifications to one or more aspects of U.S. GAAP). Examining the most common reasons for issuing financial statements with a qualified accountant's report would help in evaluating whether the guidance results in information that is not relevant to lenders' credit-making decisions that may not be relevant to other creditors and significant investors and/or whether the guidance is overly complex or costly for preparers to apply.

BC18. The Board and the PCC also should consider whether private company users commonly adjust financial statements by applying an alternative accounting method. By substituting an alternative accounting method, users incur additional time and costs to adjust financial statements to better reflect the information necessary to satisfy their objective. In addition, some users indicated that in certain instances they substitute reported amounts on the basis of their estimates determined using an alternative method because it reflects a more realistic result about future cash flows. Those users most often obtain the information necessary to make those adjustments directly from the preparer by means of discussions with management, review of due diligence questionnaires, review of tax returns, or receipt of subsequent interim financial information.

- e. Does the guidance require recognizing and measuring transactions for which uncertainty exists on the basis of the expected most likely outcome?**
- f. Does the guidance relate to loss contingencies or commitments that could significantly affect future cash flows?**
- g. Does the measurement guidance reflect volatility in financial statements resulting from underlying changes in market prices of debt instruments or certain derivatives that are expected to reverse contractually in the future because the entity has the intent and ability to hold the instrument or derivative to its defined maturity or term?**

BC19. Many private company users indicated that they prefer reported financial results and financial positions that reflect the most realistic outcome of a transaction.

BC20. As discussed in paragraphs DF6 and DF7, the investment strategies of investors in private companies often differ from those of investors in public companies. For example, many investors in private companies employ longer term holding strategies and, therefore, are less sensitive than investors in public

companies may be to short-term fluctuations in financial performance and financial position. Because private company investors are more likely to invest with a long-term focus, many do not focus on fair value measurements for debt instruments and certain derivatives, especially those involving significant unobservable inputs and when the company intends to hold instruments to their maturity or term. Those investors also argue that fair value measurements of such instruments and derivatives produce shorter term volatility in earnings and asset and liability values that are expected to reverse contractually in the future.

BC21. The Board and the PCC acknowledged that banks often require their private company borrowers to provide annual financial statements within 120 to 180 days after the end of the borrower's fiscal year and that they often provide borrowers with extensions of time to submit their financial statements. In contrast, the SEC requires issuers (with the exception of foreign private issuers) to file their annual financial statements within 60, 75, or 90 days after the fiscal year-end depending on the size of company's market capitalization. The SEC requires quarterly financial statements to be filed within either 40 or 45 days after the end of the fiscal reporting period. Because private company financial statements generally are issued much later after the end of the fiscal year than most public company financial statements, some argued that the reported amounts as of the balance sheet date often are so outdated that their usefulness is impaired. In addition, because financial statements often are finalized and made available several months after year-end, they rarely contain the latest financial information used to make investing and credit decisions. Rather, management typically provides lenders, investors, and other users with unaudited monthly or quarterly financial information.

BC22. Notwithstanding, the Board and the PCC decided to remove the consideration of lag between the year-end reporting date and the date when private company financial statements are made available to users from the list of questions that would guide the Board and the PCC in assessing whether alternatives should be provided for recognition and measurement. The Board and the PCC acknowledged the existence of a lag in financial reporting for private companies, but they could not determine how that would affect the process in determining whether recognition and measurement alternatives should be provided to private companies.

Access to Management

BC23. As discussed in paragraphs DF2–DF5, access to management cannot be a primary differentiating factor for recognition and measurement because U.S. GAAP financial statements are general purpose and must serve the needs of all users to whom they are provided. Failure to recognize or measure relevant financial information would hinder users' ability to understand the economics of the company, thereby hindering their ability to identify the questions to ask

management. That generally means that access to management should have no implications on whether there should be recognition and measurement alternatives for private companies within U.S. GAAP. That reinforces the concept that recognition and measurement differences for private companies within U.S. GAAP should be driven primarily by relevance and secondarily by cost and complexity considerations and not by considerations relating to access to management. Notwithstanding, the Board and the PCC agreed that access to management is a significant differential factor and they did not remove it from the recognition and measurement module in its entirety. This Guide still includes the consideration of access to management in evaluating potential recognition and measurement alternatives for private companies within U.S. GAAP. The Board and the PCC concluded that access to management would serve as a mitigating factor at times when the identification and development of a new alternative is evaluated because in those circumstances, access to management would work as a baseline to assess the sufficiency of the information provided within each potential alternative. The Board and the PCC concluded that this approach alleviates the concern of placing too much weight on access to management while still recognizing access to management as a significant differential factor for private companies.

Cost and Complexity

- h. Does application of the guidance often require assistance from outside resources at a significant cost?**
- i. Is significant complexity involved in determining or evaluating the initial and/or ongoing accounting treatment?**
- j. Are there expected to be significant changes to information systems, contracts, internal controls, or processes as a result of applying the new guidance?**
- k. Is the accounting treatment costly to audit, review, or compile?**

BC24. Relatively, private companies typically do not possess the same level of accounting resources that many public companies do. Consequently, many private companies may not have the resources needed to effectively and efficiently monitor the development of new accounting standards, implement complex new accounting guidance, and apply certain complex accounting guidance on an ongoing basis. Because private companies generally have relatively fewer and less specialized accounting personnel than public companies, an increased burden is placed on their resources. Private companies often incur a disproportionately large amount of external costs relative to their total accounting budgets to implement and apply accounting guidance on a recurring basis because they need more assistance from their public accountants or consultants to better evaluate and apply certain accounting standards. The cost

of modifying information systems, contracts, internal controls, or processes to comply with new accounting standards also can be disproportionately burdensome for many private companies. Many users of private company financial statements indicated that they are sympathetic to companies that consider those costs to be unduly burdensome. In some instances, users are willing to make accommodations such as accepting financial statements with a qualified accountant's report because of U.S. GAAP exceptions or obtaining information directly from management.

BC25. Because of their resource limitations, many private companies are not as regularly engaged in participating in the standard-setting process and monitoring changes in accounting guidance. Some practitioners from smaller public accounting firms that primarily serve private companies said that it is increasingly difficult for them to stay current on new accounting guidance and assist their clients in adopting that guidance in a timely manner.

BC26. Many private company preparers indicated that they lack the resources to comprehensively address the complexities associated with some of the financial accounting and reporting for areas such as derivatives, share-based payments, fair value measurements, and deferred income taxes, all of which may require them to engage outside professionals and obtain assistance from their public accountants. That resource shortfall is more prevalent in small and medium-sized private companies, but it also affects many small public companies. Some preparers and public accountants of private companies said that the increasing complexity of recognition and measurement guidance has increased the frequency of financial reporting errors, delayed the issuance of financial statements, and increased the costs of compliance because of the high level of outside assistance required from public accountants and topical experts and specialists. Those preparers and public accountants said that the result is that a growing number of private companies have elected to prepare their financial statements using an alternative basis of accounting or have applied U.S. GAAP with exceptions.

BC27. The Board and the PCC should consider those limitations of accounting resources and concerns about complexity in assessing both the one-time implementation costs and the subsequent recurring costs of applying recognition or measurement guidance incurred by private companies in relation to the benefits received by the typical users of their financial statements.

2: Determining Disclosure Requirements

BC28. The considerations underlying the views on determining disclosure guidance for private companies are much the same as those that support the views on recognition and measurement. Paragraphs BC29–BC42 review the considerations that are especially pertinent to disclosure guidance and discuss comments on disclosures received from stakeholders.

BC29. Many preparers of private company financial statements said that the costs of preparing and auditing or reviewing what they perceive to be a growing volume of extensive disclosures often outweigh the benefits to the users of their financial statements. Both users and preparers of private company financial statements noted that while general purpose financial statements should include an appropriate level of disclosures to provide relevant information to financial statement users, it often is unnecessary to require private companies to disclose the same level of detail required in public company financial statements. Those stakeholders cited the following considerations:

- a. The typical information needs of users of private company financial statements
- b. The extent of knowledge that typical users of private company financial statements often already have about the reporting entity
- c. The ability of users of private company financial statements to access management to obtain additional supporting information.

BC30. Some preparers and users of financial statements of both private companies and public companies said that preparing financial statement disclosures has taken on a checklist-style approach. They said that approach often results in boilerplate information that provides limited insight for financial statement users. Some preparers also said that many public accountants have contributed to a checklist-style approach by exercising a high level of conservatism that does not sufficiently incorporate both qualitative and quantitative materiality considerations when evaluating the completeness of note disclosures. The Board is addressing broad concerns about disclosure effectiveness and the factors that sometimes make disclosures ineffective in its current project to develop a disclosure framework, which is intended to benefit both private companies and public companies.

BC31. As discussed in paragraph BC10, it is important to focus on the most common types of users of private company financial statements in evaluating the relevance and costs of guidance on recognition and measurement. The same is true for guidance on disclosures. Paragraphs BC9–BC16 explain that the most common types of users of private company financial statements are lenders and other creditors and investors and discuss their significant areas of focus.

BC32. Because private company preparers have greater control over the initial distribution of their financial statements than public company preparers, they

generally know who is using their disclosures, and most of those private company preparers are familiar with their users' most significant areas of focus. Therefore, preparers can tailor the nature and extent of their disclosures to best address their users' needs. While annual and interim financial statements generally are a significant factor in making investment decisions about public companies, most investment decisions about private companies are primarily based on other due-diligence activities, in part because of the lag between the year-end reporting date and the date financial statements are issued and made available to users.

BC33. Private company disclosures aimed at satisfying investors should focus primarily on the needs of existing investors that, in most cases, are familiar with the company and have direct access to management, rather than on the broader and lesser known needs of potential investors and other users. Paragraph BC14 describes the typical areas of focus of lenders and explains that many lenders said that they typically receive a much greater level of detail about those areas directly from management throughout the year in contrast to the limited information that is included in annual financial statements. Therefore, some lenders and other users said that they do not need notes that contain an extensive amount of detail, particularly about certain inputs and assumptions used in preparing financial statements. Instead, many users indicated that the accompanying public accountant's report is sufficient confirmation that the inputs and assumptions underlying the information recognized in financial statements are reasonable and that they can obtain additional details, if necessary, from management.

BC34. Many users of private company financial statements said that mandatory and extensive disclosure requirements have resulted in notes that often do not capture the information that is most relevant to their decision making. That excessive information also results in a cost to the users because they must sort through the financial statement notes to locate the information that they need for their decision-making process. However, some users and preparers of public company financial statements also have made similar observations. Both private company investors and lenders indicated that they commonly request additional information from management, including requests for both U.S. GAAP and non-U.S. GAAP measures, and ask questions to supplement their review of financial statement notes.

BC35. Financial statement disclosures must contain a sufficient level of baseline information to be relevant for investing or credit-making decisions. Users of private company financial statements typically interact with management at regular intervals throughout the year and receive monthly or quarterly financial information. As a result, many users stated that they are rarely surprised by the content of annual financial statements and notes and that they view annual financial statements as third-party confirmation of their prior observations of the company's performance over the year. Users of private company financial statements generally place minimal value on disclosures about most noncash

transactions, particularly those of a nonoperating nature. Many users said that they prefer notes that are relevant to their needs and less complex because those notes improve the transparency and usefulness of financial statements. Some users of private company financial statements observed that the notes about commitments, risks, and contingencies would be more valuable and less lengthy if they focused more on the facts about the matter rather than on management's views and estimates because some users prefer to further discuss the matters with management and arrive at their own conclusions.

BC36. Generally, the Board and the PCC should consider not requiring the disclosure by private companies of tabular reconciliations of beginning and ending balance sheet accounts because many private company users have said that (a) they do not need this detailed information, (b) private company users that may want this information often can obtain it directly from the preparer, and (c) the cost of preparing and auditing or reviewing information at that implied level of precision could be more than insignificant. If users indicate a need to understand why the amounts of particular types of assets and liabilities changed during a reporting period, the Board and the PCC should consider whether an alternative requiring private companies to provide a nontabular description or, in other words, a narrative of the significant changes would address users' needs in a more cost-effective manner than requiring tabular account reconciliations. That explanation might include both qualitative and quantitative information about the reasons for significant changes in those accounts. However, when evaluating the potential cost savings and benefits of providing a narrative, the Board and the PCC should consider that some users may find a tabular reconciliation presentation easier to locate and understand.

BC37. The Board and the PCC should consider whether private companies should provide the same disclosures as public companies under accounting guidance that specifically relates to one of a private company's significant businesses. Those disclosure requirements could be relevant to most financial statement users given the unique nature of some industries and the often specialized accounting guidance that they must apply.

BC38. The general ability of users of a private company's financial statements to obtain additional information beyond what is included in financial statements may be particularly pertinent in considering disclosure requirements. However, some private companies said that their users often request forward-looking information rather than additional details about historical information included in financial statements.

BC39. Because of the users' greater access to management and the often closer relationships between private companies and their investors and lenders, many preparers and users of private company financial statements said that there is less need for mandatory, extensive note disclosures in private company financial statements than in public company financial statements. Many users indicated that they use the notes as a secondary source of information to validate

previous knowledge and expectations and to engage in a more focused dialogue with management in what can be described as a *red-flag approach* to review.

BC40. An example of a red-flag approach to disclosures about contingencies would be when many users of private company financial statements typically have previous knowledge of contingencies and commitments before they read about them in the notes but, after reviewing the notes, they likely would engage in follow-up discussions with management about the status and potential resolution of those matters. Therefore, under a red-flag approach, some information in the notes can be limited to basic information necessary to facilitate a user's review and to allow a user to identify appropriate follow-up questions to present to management when the user deems it necessary to do so. However, in evaluating the benefits and costs of providing disclosure alternatives for private companies within U.S. GAAP, the Board and the PCC should consider whether the remaining disclosure requirements in a particular area would provide typical users of financial statements with enough information to facilitate an effective red-flag approach.

BC41. The cost and complexity of complying with disclosure requirements also can be challenging for public companies, particularly small public companies. However, cost and complexity often are more pertinent in conducting a cost-benefit analysis for private companies because the resulting information may not necessarily be very relevant to many of the users of their financial statements. Some preparers of private company financial statements raised concerns that extensive, disaggregated disclosure requirements increase the risk that confidential information may be released to unauthorized parties. While private company preparers control to whom they release their financial statements, for example, specific vendors or customers, some remain concerned about the risk that proprietary information may be provided to their competitors, other unauthorized parties, or others that do business with their competitors. Those preparers noted that a significant benefit of being a privately held company is the ability to avoid disclosing proprietary information that could result in a competitive disadvantage or increased liability exposure.

BC42. In addition to considering the extent to which many users of private company financial statements do not need the same information that users of public company financial statements do, the Board and the PCC should consider whether private company financial statements can be made more relevant by requiring additional or modified disclosures as long as the benefits justify any increase in costs. Examples might include information about the timing and amount of distributions paid to owners, related party relationships, and income tax sharing arrangements.

3: Determining Display Requirements

BC43. To promote comparability, private companies generally should apply the same financial statement display guidance as public companies. If the Board concludes that financial information is important enough to be included on the face of financial statements, an alternative for private companies within U.S. GAAP would be warranted only in limited circumstances. Also, many stakeholders have indicated that the fundamental look and feel of financial statements presented in accordance with U.S. GAAP should not vary significantly between public companies and private companies. For example, because the reclassification of amounts from other comprehensive income to net income does not affect reported cash amounts, it may be sufficient to disclose such reclassifications in the notes rather than on the face of private company financial statements. However, some stakeholders said that given the importance of the income statement and statement of comprehensive income, the form of their presentation should not vary significantly between private companies and public companies.

BC44. Given the importance of the cash flow statement to users of financial statements of most private companies (excluding financial institutions), most of those users likely would benefit from all amendments that require further disaggregation of line items in the cash flow statement. Clear examples of situations in which private companies should be provided with an alternative to display requirements include circumstances in which the information does not apply to or is not required for private companies, such as earnings per share and segment information. In other instances, such as display matters affecting the balance sheet, the Board and the PCC should evaluate the relevance of the proposed financial information on a standard-by-standard basis by applying the guidance on display included in this Guide.

BC45. The Board and the PCC decided to remove industry-specific considerations from the display module. Because the display module includes a presumption that private companies generally should apply the same financial statement display guidance as public companies, an industry-specific presumption or consideration was considered to be redundant.

BC46. Before assessing the relevance of information to be displayed on the face of financial statements, the Board and the PCC should first assess whether there is a basis for permitting an alternative for private companies within U.S. GAAP to the recognition, measurement, or disclosure of the underlying financial statement component.

BC47. In determining the display requirements of financial information, the Board and the PCC should assess the relevance and importance of that information to private company investors, lenders, and other creditors by considering the following:

- a. The type of financial information on which typical users of private company financial statements focus (primarily amounts that affect reported cash balances, cash flows, or adjusted EBITDA)
- b. Input from private company users and preparers that cluttered financial statements sometimes result in confusion and may shift the focus away from areas of greater importance.

The discussion of the recognition and measurement areas in the basis for conclusions of this Guide further describes the considerations of item (a) in this paragraph. The Board and the PCC should place more weight on the relevance to users of financial statements, but they also should consider whether the guidance on display will result in significant incremental costs.

BC48. Both preparers and users of private company financial statements often complain about the large volume of disclosures included in the notes. Notwithstanding, to achieve a simpler presentation on the face of financial statements, users of private company financial statements often prefer disclosure of relevant disaggregated financial information or supplemental financial information in the accompanying notes. For example, some private company users are interested in seeing inventory disaggregated by type such as raw materials, work in process, and finished goods. However, many users said that it would be sufficient to include such details in the notes rather than to add additional line items to the face of the balance sheet.

BC49. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states that information disclosed parenthetically on the face of financial statements amplifies or explains information recognized in financial statements. Considering how typical investors, lenders, and other creditors use private company financial statements, presenting information parenthetically on the face of private company financial statements may be unnecessary in many situations. As further described in the recognition and measurement and disclosure areas of the basis for conclusions of this Guide, the unique characteristics of private company financial statement users often provide a sufficient basis for providing alternatives for private companies within U.S. GAAP. Those factors include the following:

- a. There are extensive relationships that often exist between users and preparers of private company financial statements.
- b. Financial statements represent just one component of financial information (for example, accounts receivable aging, accounts payable aging, budget versus actual financial results, financial projections, income tax returns, and due diligence questionnaires) used to make investing or credit-making decisions.
- c. Many users use private company financial statements as a secondary source of information to validate their previous knowledge and expectations and to potentially engage in a more focused dialogue with

management about the company rather than to gain their primary understanding of the company's financial performance and position.

BC50. In deciding whether to require entities to disclose disaggregated or supplemental information on the face of financial statements, the Board has historically considered, among other factors, that many public companies include a balance sheet, income statement, and statement of cash flows in their public earnings release before they issue a complete set of financial statements. But, private companies do not follow that reporting sequence. As a result, many private company financial statement users stated that including relevant supplemental information in the notes generally is sufficient.

4: Determining the Effective Date of Guidance

BC51. In recent years, the Board typically has deferred the effective date of the amendments in Accounting Standards Updates for private companies and not-for-profit organizations for a period of one year following the effective date for public companies. The Board's basis for the deferrals includes the following:

- a. The typical periodic timing of the learning and education cycle for preparers of private company financial statements and many of their public accountants
- b. The ability of private companies and their public accountants to learn from the earlier implementation experiences of public companies
- c. The availability of, and competition for, third-party resources to assist in implementing new guidance
- d. The lead time necessary to provide instructors and materials for training a large and broadly distributed audience of private company financial statement preparers, public accountants, and users.

BC52. For the same reasons described in paragraphs DF12 and BC51, the effective dates for private companies often have been for annual fiscal year-ends rather than for interim periods within the initial year of adoption.

BC53. A primary reason for a one-year deferral of the effective date for private companies is to mitigate the risk that some preparers, public accountants, and, to a lesser extent, users of private company financial statements may not become aware of or may not be adequately trained in the new accounting guidance in a shorter period because of their typical education cycle. As discussed in paragraphs DF12 and DF13, typically, much of the education cycle about new accounting guidance for private company stakeholders occurs in the second half of the calendar year. Providers of continuing professional education that deliver midyear education sessions typically do not include training for amendments that are not issued as final before February or March. Because of those reasons, the decision to provide a one-year deferral period should not be rejected when particular amendments either are not viewed as being complex or do not affect recognition or measurement in financial statements.

BC54. Because of the quarterly frequency of public reporting requirements and public companies' greater level of accounting resources, many preparers and auditors of SEC registrants are more regularly engaged than some preparers and public accountants of private companies in identifying and learning about proposed and final changes in financial accounting and reporting guidance. The logistics of providing appropriate training for private company financial statement preparers and their public accountants often are more complex and require additional time because their population is very large, diverse, and more widely dispersed than that of public companies.

BC55. The typical relative investment in accounting resources of private companies and public companies discussed in paragraphs DF10 and DF11 also is pertinent in considering the appropriate effective date of new guidance for private companies because private companies generally have fewer and less specialized accounting personnel than public companies. As a result, private companies often require additional time to implement new guidance, and many private companies and/or their public accountants acquire valuable knowledge and achieve significant efficiencies from observing the earlier implementation experiences of public companies and their public accountants.

BC56. In limited circumstances, the Board and the PCC may determine that there is no need to defer the effective date by one year after the first annual period required for public companies because the Board has provided public companies with an extended period of time to adopt the amendments. However, the Board and the PCC should carefully consider the complexity of the amendments; the availability of, and competition for, third-party resources to assist in implementing the new guidance; the method of transition; and the extent to which private companies and their public accountants would benefit by learning from the earlier implementation experiences of public companies.

BC57. If public companies are permitted to early adopt amendments, private companies generally also should be permitted to early adopt the amendments, provided that they do so no earlier than the effective date for public companies. That approach would provide private companies with the flexibility to achieve comparability of their financial statements with public company financial statements earlier than required if they decide that it is important to do so.

BC58. Many users of private company financial statements indicated that a deferred effective date of one or two years beyond the effective date for public companies does not significantly affect their use of private company financial statements. Many private company users, particularly lenders, sureties, and some investors, stated that they rarely compare private company financial statements directly with public company financial statements. Other users, including some that use both private company and public company financial statements, indicated that while comparability between private company financial statements and public company financial statements would be ideal, they understand the cost-benefit considerations for private company financial

statements. Therefore, many users said that they generally support deferred effective dates for private companies. Some users of private company financial statements said that the deferral period provides them with additional time to learn about the new guidance. Some stakeholders said that, ultimately, a deferred effective date also may give users more assurance that financial statements appropriately reflect the effect of the amendments. Deferred effective dates also provide users of private company financial statements with more time to assess how the change will affect their analyses and the private company's debt covenants. However, some users of both private company and public company financial statements prefer that effective dates not be deferred beyond one year because the deferral would result in a longer period of noncomparability.

5: Determining the Transition Method for Applying Guidance

BC59. Lenders often are the most common type of user of private company financial statements; therefore, private company financial statements should include information that adequately addresses the typical needs of lenders. Most lenders require at least two years of comparative financial information to make credit decisions. However, some lenders to private companies indicated that because they understand the cost-benefit considerations of applying a retrospective method of application, they would be willing to accept an alternative transition method if the effect on comparability is not expected to be significant to important financial metrics such as reported cash balances, cash flows, adjusted EBITDA, working capital, and total borrowings. They also would accept a transition method other than retrospective if, upon request, management can provide those lenders directly with unaudited comparative financial information. Some lenders said that although they require comparative financial information, they do not necessarily need it to be included in financial statements if the borrower discloses the change and explains the significant differences resulting from applying the change in guidance.

BC60. In addition to lenders, other users of private company financial statements, including sureties, investors, and regulators, said that comparability between reporting periods is more important for evaluating the effect of some amendments than it is for others. If amendments do not affect their areas of common focus, the benefits of neither a full nor a modified or limited retrospective transition method are likely to warrant the related costs. In contrast, amendments that significantly affect the reporting of sources of cash inflows and outflows or debt and liquidity measures may make it difficult for the user to separate the effects of actual financial performance from the effect of the amendments and, thus, may warrant some form of retrospective application.

BC61. Many preparers of private company financial statements said that the Board and the PCC should consider alternatives to a retrospective transition method for amendments that do not significantly affect the reporting of sources of

cash inflows and outflows or debt and liquidity measures because the cost of applying a retrospective method often outweighs the benefit to the users of their financial statements. They said that, in many cases, users of private company financial statements do not need amendments to be applied retrospectively because of the following:

- a. They generally do not focus on most noncash adjustments and, with few exceptions, the adoption of new amendments does not affect reported cash balances or cash flows.
- b. Many users, such as existing equity investors, vendors, lessors, and customers, are not as concerned about the effect on prior-period financial statements because they are more interested in current-period and future results. Those users often do not use financial statements as a primary source for making projections primarily because of the lag between the year-end reporting date and the date that financial statements are issued and made available to users.
- c. Many users can access management if they want to understand the effect of the amendments on prior-period results, and many of those users do not require that information to be included in financial statements.

BC62. As discussed in other areas in this Guide, many preparers of private company financial statements have relatively fewer accounting resources. Therefore, they incur relatively higher costs than public companies to modify systems and engage public accountants and other external professionals to implement amendments using a retrospective method of adoption.

BC63. Concepts Statement 8 and Topic 250, Accounting Changes and Error Corrections, emphasize the importance of comparability and consistency in understanding U.S. GAAP financial statements. While the guidance in Topic 250 addresses only voluntary changes in accounting principles and unusual situations in which transition guidance is not provided for new amendments, it requires retrospective application of changes in accounting principles to prior-period financial statements. However, that guidance acknowledges cost-benefit considerations by permitting prospective application if retrospective application is impracticable. Concepts Statement 8 also discusses cost-benefit considerations in determining the extent of information to be provided to the various users of general purpose financial statements.

BC64. Permitting private companies to apply an alternative transition method may contribute to a lack of both consistency within a private company's financial statements and comparability of financial statements of different companies. However, requiring a private company that applies an alternative transition method to disclose qualitative information about how the amendments affect the comparison of its financial statements should mitigate some of the negative effects of that lack of consistency and comparability. In limited circumstances in which the amendments significantly affect information that users of private

company financial statements find relevant, a private company may be required to disclose quantitative information about how the amendments affect the comparison of its current-period financial statements with its prior-period financial statements. Those disclosures also should provide an appropriate level of information to facilitate the red-flag approach that many users of private company financial statements use to identify potential significant or unusual items that may require discussion with management.

BC65. The Board and the PCC considered not providing any level of transition relief to private companies because U.S. GAAP does not require private companies to present comparative financial statements. However, Topic 205, Presentation of Financial Statements, encourages a comparative presentation and describes such presentation as ordinarily desirable. The Board and the PCC also considered the following input received from stakeholders:

- a. In practice, many private companies prepare comparative financial statements.
- b. Typical users of private company financial statements expect to receive comparative financial statements. Presenting single-period financial statements solely to avoid the cost and complexity of applying retrospective transition during some years would result in an inconsistent presentation and could cause confusion.
- c. Many lenders and some other users of private company financial statements rely on comparative statements to ensure that the prior-period figures that they previously included in their analyses agree with the latest reported balances.
- d. In some regulated industries such as banking, the regulator requires comparative financial statements.