Ball State University
ACC 675 Seminar in Financial Accounting (Team 1)
Muncie, Indiana 47303

October 11, 2012

Technical Director
File Reference No. 2012-230
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: July 2012 Private Company Decision-Making Framework

We appreciate the opportunity to comment on the above-referenced framework. Prior to commenting on specific recommendations set forth by the FASB staff in the document, we would like to address the issue of the definition of a private company. We understand that the Board plans to expose the definition of a private company for public comment prior to finalizing its decision as to what constitutes a private company. However, in any discussion of proposed modifications of, or exceptions to GAAP for private companies, agreement must first be reached on what constitutes a private company.

Private versus Public Companies

The Board is adding confusion to the discussion of private versus public company accounting standards by continuing to use the word “private” to distinguish nonpublic entities from public ones. Most people would consider “private” all companies that do not issue securities in a public market. The Board has already tentatively determined that this definition is too narrow to use when determining whether or not a company should be subject to public company financial reporting standards. We propose that the Board adopt the term “For-Profit, Non-Public Entities” to distinguish certain non-public companies from public ones for purposes of financial reporting standards. We will, however, use the term private company in the remainder of this letter when referring to entities that are not public companies to conform to the framework.

We agree with the Board’s tentative decision to exclude the following entities from qualifying as a private company:
a. Any company that files or furnishes financial statements with a regulatory agency for purposes of issuing securities in a public market or issuing securities that trade in a public market

b. Any company that is a for-profit conduit bond obligor for conduit debt securities that are traded in a public market

c. Any employee benefit plan.

We do not agree, however, with the Board’s view that public accountability should not be a factor in determining whether or not an entity should be considered private for financial reporting purposes. The possibility exists whereby financial statements provided by government regulated entities as part of the regulatory process will become public records. It is too much to expect that the general public, and even some regulators, would understand that these financial statements were not prepared in the exact same manner as those of similar public companies. Therefore, we believe all regulated companies that provide financial statements as part of the regulatory process should be considered public companies for financial reporting purposes. This would include all financial institutions, insurance companies, regulated utilities, etc.

Currently, some of the definitions in the Codification include the criterion that an entity controlled by a public entity is considered to be a public entity. We believe this definition should be expanded so that a private entity controlled by a public entity is always considered to be a public entity for financial reporting purposes. It makes little sense to allow private companies controlled by public companies the option of issuing different standalone financial statements than those issued to the controlling public company so consolidated financial statements can be prepared. Private companies controlled by public companies are subsidiaries of the public company and should be held to the same standards of financial reporting. The possibility of conflicting information appearing in the market resulting from two different sets of financial reports for a controlled entity far outweigh any potential advantages of allowing publicly controlled private companies to use different financial reporting standards.

Lastly, we believe that any private company owning a public company should also be required to prepare financial statements as if it were a public company. We disagree with the Board’s conclusion that a private company that controls and consolidates a public company has the same characteristics and financial statement user needs as a private company not controlling a public company. The users of these private company’s financial statements have needs more closely resembling those of public company financial statements. The decision of private companies to purchase a controlling interest in a public company should automatically trigger public company financial statement reporting standards in the controlling private company. Transparency demands no less.

If the Board is to expand the differences in private company financial reporting standards, it is in the public’s best interest for the Board to come up with a clear, easily understood definition of a private company. To this end we recommend adding the following three entities to the three the Board has tentatively decided to exclude from qualifying as a private company:
d. Any company that provides financial statements to regulators as part of the regulatory process

e. Any company that is a consolidated subsidiary of a public company

f. Any company that controls a public subsidiary.

Significant Differential Factors Affecting Private Companies

While we agree with most of the staff’s differential factors affecting private companies, we would like to specifically address three of the factors where we disagree with some aspect of the assumptions used by the staff.

Types and Number of Financial Statement Users

We agree with the staff that financial statements of private companies typically have a much smaller number of users than financial statements of most public companies. However, this fact should in no way influence financial reporting standards. Standards are designed to provide useful information to users of financial statements. The actual number of users of a company’s financial statements is irrelevant to the usefulness of the information provided.

We agree with the staff that public company equity and debt investors as well as analysts are the most common users of public company financial statements, whereas lenders and other creditors as well as equity investors are the most common users of private company financial statements. For this reason alone, the Board should consider both the users of public and private company financial statements when proposing revisions to existing standards as well as new standards. The needs of the two groups are different. For example, the Board has already recognized that earnings per share (EPS) is a driving metric in analyzing public company financial statements, but is seldom, if ever, used when analyzing private company financial statements and so allowed a private company exception from reporting EPS. Allowing other pertinent exceptions in the preparation of private company financial statements would help reduce the cost of preparing those statements without sacrificing relevant information.

We agree with the staff that private companies control to whom they give their financial statements. However, we’d like to point out that private companies sometimes have little or no control over the financial statements once they are issued. This is especially true with regulated companies where financial statements may become a matter of public record.

Access to Management

We agree that in most cases, users of private company financial statements have direct access to management. This level of access, however, varies among different users due to time, convenience, and other factors. Therefore, financial reporting standards cannot assume that all users of private company financial statements will be able to obtain needed information from management. The staff’s recommendation that greater access to management be considered in assessing the nature and extent of disclosure requirements is valid. However, their recommendation that the level of access to management of private companies should be considered in evaluating the recognition and measurement of amounts in private company financial statements assumes too much. Users of private
company financial statements will ask management for needed information if it is not disclosed in the
financial statements. But, if recognition and measurement methods differ for private companies, users
may not realize that the information they are analyzing has not been recognized or measured in the way
they thought. Not realizing this, they may make erroneous conclusions.

Accounting Resources
Although private companies generally have smaller accounting resources and must rely on public
accountants to help them with complex transactions, this is not a valid reason for different financial
reporting standards. In fact, the greater reliance on public accountants by private companies should
bring new and changed accounting standards to the attention of private companies quickly. It is the duty
of public accountants to remain current on new and revised standards. This is one of the reasons why all
public accountants must undergo continuing professional education. It is simply not acceptable to delay
effective dates for private companies because some public accountants are not keeping up with new
and revised standards. The fact that most public accountants take their continuing education courses in
the second half of the year reflects a choice made by those public accountants. It should not factor into
any decision made by the Board as to when effective dates for accounting updates should be
implemented.

This does not mean that private companies should always be held to the same effective dates in
implementing an Accounting Standards Update as public companies. Unless the Board determines that
an earlier date better serves the public interest, an effective date of one year beyond the first annual
period required for public companies should allow private companies and their public accountants
enough time to adopt the update. We do not agree that two years beyond the first annual period
required for public companies would be better. The extra time could result in increased confusion over
comparability without any compensating benefit (except for delay) for private companies. Private
companies should be allowed to adopt Accounting Standards Updates before the deferred effective
date for private companies, but no earlier than the required or permitted effective date for public
companies.

Preliminary Staff Recommendations

Industry-Specific Guidance
We firmly believe that there should be no exceptions for private companies in following industry-specific
guidance incorporated into Accounting Standards. Many industries have unique accounting treatments
of specific items. There is no underlying economic reason why an industry-specific transaction should be
treated one way by a private company and a different way by a public company.

However, private companies that are required to follow industry-specific guidance in the Codification
should be allowed the option of implementing private company exceptions allowed in other general
(non-industry-specific) standards.
All or Nothing Implementation

If the goal of implementing private company exceptions to financial reporting standards is to allow private companies to provide relevant information to users of their financial statements, then private companies should be allowed to pick and choose which exceptions to public company standards they implement. Of course any exceptions implemented would have to be fully disclosed in the notes to the financial statements, perhaps in a new required disclosure note titled “Implemented Exceptions to Public Company Reporting Standards.”

It is unlikely that private companies would implement any exceptions to the Accounting Standards if the Board required them to then implement all future exceptions. Companies have no idea what exceptions the Board will implement in the future and so could not in good faith commit to implementing those exceptions. Private companies would most likely adopt a wait and see attitude which would defeat the purpose of providing exceptions to private companies in the first place.

Not only should private companies be allowed to pick and choose which exceptions they want to implement, they should also be allowed to discontinue an exemption implementation should they find the implementation results in less than useful financial statements. However, any change back from an exception should be required to be done retrospectively so as to prevent any possible manipulation of financial statements through the use of private company exceptions to financial reporting standards.

Display and Presentation

Generally, private companies should use the same presentation guidelines for financial statements as public companies. However, the Board should realize that over time it will allow exceptions for private companies on the presentation of their financial statements. Therefore, we propose that the title of ALL financial statements of a private company that has implemented ANY private company exceptions include the words, “These Financial Statements Have Been Prepared Using Allowed Private Company Exceptions – See Disclosure Notes for More Information.” This notice will allow users to immediately know that the financial statements they are looking at contain private company exceptions.

Overall, we think the staff has done an excellent job in researching and compiling the draft framework and look forward to reviewing the Board’s proposed framework. We appreciate the opportunity to comment on this draft framework. Questions about our comments may be directed to any member of our team.

Respectfully submitted,

Kyle Anderson  Roger Crane  Anqi Fang
Daniel Maggart  Greg Manning