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Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 21 June 2013

Re: Invitation to Comment: Private Company Decision-Making Framework, A Guide for Evaluating Financial Accounting and Reporting for Private Companies (File Reference No. 2013-250)

Dear Ms. Cosper:

As the auditor of more than 3,000 private entities, we appreciate the opportunity to comment on the Invitation to Comment (ITC) on a Private Company Decision-Making Framework, A Guide for Evaluating Financial Accounting and Reporting for Private Companies.

We support the use of a framework to help the Private Company Council (PCC) and the Financial Accounting Standards Board (FASB or Board) make decisions about alternatives for private companies under US GAAP. We also support providing relief to private companies under US GAAP while maintaining relevant information for the users of private company financial statements.

We agree with the goal of the framework that alternatives provided to private companies should not result in a fundamentally different basis for preparing financial statements. We believe that achievement of this goal will largely depend on the nature and extent of any recognition and measurement alternatives that might be afforded to private companies. In that context, we suggest the framework include additional guidelines to aid the PCC and Board in evaluating recognition and measurement differences.

We suggest recognition and measurement alternatives that are provided to private companies normally should:

- ▶ Have objectives that are similar to the recognition and measurement objectives for public companies
- Provide practical expedients for initial recognition and measurement
- Be disclosed in accounting policies
- Not create significant obstacles if an entity decides to go public



We recognize, in some instances, the nature of the underlying differences between public and private entities may dictate different accounting. One example is using a calculated value to measure share-based payments for private companies. We believe such an alternative is appropriate.

As noted in the ITC, a key difference between private and public companies is that private company users have greater access to management. As a result, they are able to obtain additional details about the amounts in the financial statements. Therefore, private companies should be allowed to make fewer disclosures in the notes to the financial statements than public companies. This could reduce the burden of financial reporting for private companies.

The ITC notes that transition to new accounting standards can be especially challenging for private companies. We believe the PCC and the FASB can reduce this burden on private companies by allowing (1) adoption of new standards at the end of the annual period rather than in an interim period, (2) modified retrospective transition, instead of a full retrospective transition, and (3) at least an extra year for transition when appropriate. We applaud the FASB for providing transition relief to private companies in recent standard setting.

Providing substantive relief to private companies for disclosures and transition could alleviate a significant amount of the burden they face in preparing financial statements. By focusing on this kind of relief, the PCC and the FASB could help further ensure that the fundamental basis of accounting for private and public companies remains the same.

The ITC notes that public companies share many of the concerns of private companies. The FASB has indicated that it intends to apply certain relief initially identified as an alternative for private companies more broadly to all companies. We applaud the FASB for this open-minded approach and encourage the Board to consider whether each private company accommodation can be extended to public companies. If complexity and volume can be reduced for all entities, the need for alternatives for private companies may be reduced.

We also encourage the PCC and the FASB to finalize the definition of a nonpublic entity, which drives the scope of the framework, before finalizing the framework. We believe that the FASB's current project on the definition of a nonpublic entity should result in a single, straightforward definition that is incorporated into existing accounting standards and used consistently in future standard-setting activity. For example, a nonpublic entity might be any entity that is not an issuer and/or is not otherwise considered a "public" company by a primary regulator (e.g., an entity subject to filing with the Securities and Exchange Commission when it does not have public debt or equity outstanding).

In the Appendix to this letter, we provide our responses to the Board's specific questions in the ITC.

Overall, we believe the proposed private company decision-making framework could be used to help ease the financial reporting burden on private companies. We also continue to fully support the FASB, with the input of the PCC, as the standard setter for US GAAP for private companies.

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We would be pleased to discuss our comments with the PCC, the Board or the FASB staff at your convenience.

Very truly yours,

Ernst + Young LLP

Responses to the Questions for Respondents in the Invitation to Comment: Private Company Decision-Making Framework, A Guide for Evaluating Financial Accounting and Reporting for Private Companies

This Appendix includes our responses to questions addressed to all respondents or specifically to auditors. We have not responded to questions addressed only to preparers or users.

Question 1: Please describe the individual or organization responding to this Invitation to Comment.

- a. Please indicate whether you are a financial statement preparer, user, or public accountant, or if you are a different type of stakeholder, please specify. Please indicate if you are both a preparer and a user of financial statements.
- b. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your business and its size. If applicable, describe any relevant prior experience in preparing financial statements for private companies or public companies.
- c. If you are a user of financial statements, please indicate in what capacity (for example, investor or lender) and whether you primarily use financial statements of private companies or those of both private companies and public companies.
- d. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on private companies or both private companies and public companies.

Ernst & Young LLP is one of the largest firms auditing both public and private entities. We currently audit approximately 3,000 private entities, ranging from small start-ups and family-owned enterprises to large privately held multinational corporations.

Question 2: Do you agree that this guide is based on the appropriate differential factors between private companies and public companies (see paragraphs DF1-DF13)? If not, please explain why and include additional factors, if any, that you believe should be considered along with their potential implications to private company financial reporting.

The differences identified are reasonable, but others might exist. For example, some believe the size of the organization also is relevant to decision making about accommodations.

However, a number of issues described in the ITC also can apply to public companies. Paragraph DF3 of the ITC, for example, states that private company users "focus on cash-adjusted earnings from operations (earnings before interest, tax, depreciation, and amortization [EBITDA], with some additional noncash adjustments)." This focus is discussed throughout the framework, which acknowledges that public company equity investors and analysts also look at EBITDA along with other measures. We believe that many analysts evaluate public companies based on EBITDA. Debt covenants for public companies, for example, often include an EBITDA criterion.

In addition, paragraph BC27 of the ITC states that public companies also are concerned "about what they perceive to be burdensome costs and complexity" of current accounting guidance. Paragraph BC48 of the ITC indicates that "the cost and complexity of complying with disclosure requirements also can be challenging for public companies," and paragraph BC40 of the ITC indicates that public company preparers and users also have observed 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."

We believe it is important to consider whether PCC recommendations also should be applied to public companies.

Question 3: Overall, do you agree that this guide would lead to decisions that provide relevant information to users of private company financial statements in a more cost-effective manner? If it does not, what improvements can be made to achieve those objectives?

We support the plan to establish a framework to help the PCC and the FASB make decisions on whether and when alternatives for private companies under US GAAP are appropriate. We believe a framework is important to maintain consistency and transparency in the process. As discussed in our cover letter, we believe that providing relief to private companies by using practical expedients for recognition and measurement alternatives, reducing disclosures and modifying transition requirements could help the PCC and the Board meet their objective of providing relevant information in private company financial statements in a more cost-effective manner while preserving the same fundamental basis of accounting for public and private companies.

Question 4: With respect to industry-specific guidance:

- a. Do you agree that this guide appropriately considers industry-specific accounting guidance for private companies? That is, should private companies follow the same industry-specific guidance that public companies are required to follow in instances in which the Board and the PCC determine that the guidance is relevant to financial statement users of both public companies and private companies operating in those industries? If not, why?
- b. Do you think factors other than user relevance, such as cost and complexity, should be considered when the Board and the PCC are determining whether or not to provide alternatives within industry-specific guidance?
- c. Do you think that industry-specific accounting considerations should be different between (i) recognition and measurement and (ii) disclosure?

Industry-specific guidance is intended to help users understand the unique nature of transactions in certain industries. Providing industry-specific guidance also helps ensure consistent application of guidance by preparers across an industry. We believe that the concerns that prompted industry-specific guidance apply to both public and private entities. We also believe many users of industry financial statements may want comparable information across the industry for both public and private company financial statements. We therefore believe that industry-specific information is usually

relevant (but should not be presumed to be relevant as the staff had suggested) to the users of private company financial statements and that industry-specific guidance generally should be the same for public and private companies.

Question 5: Do the different sections of this guide appropriately describe and consider the primary information needs of users of private company financial statements and the ability of those users to access management, and does the disclosure section appropriately describe the *red-flag approach* often used by users when reviewing private company financial statements (see paragraphs BC45 and BC46)? If not, why?

Paragraph OB5 of Statement of Financial Accounting Concepts No. 8 states that general purpose financial reports are directed to users who "cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need." As noted in the ITC, a key difference between public and private companies is users' access to management. Given their greater access, users of private company financial statements often are able to obtain additional details.

We believe this access, along with the observation in paragraph BR35 of the ITC that users often believe that disclosures can be reduced, supports a reduction in the volume of required disclosure. A private company could always provide disclosures beyond the minimum requirements, if it desired. Therefore, private companies should be allowed to present fewer disclosures in the explanatory notes to the financial statements than public companies. However, we believe disclosure overload also is an issue for public companies.

Identifying and understanding the needs of typical users of private company financial statements is critical to the effectiveness of the framework. We believe that when considering specific alternatives for private companies under US GAAP, the PCC and the Board should continue to include both preparers and users in the decision-making process.

We believe that referring to the red-flag approach in the framework is unnecessary. The description is confusing and doesn't explain what is meant by "basic information necessary to facilitate a user's review and to allow a user to identify appropriate follow-up guestions."

Question 6: Paragraph 1.5 includes the following questions for the Board and the PCC to consider in the recognition and measurement area of the guide:

- 1.5(e) Does the guidance require that the threshold for recognizing or measuring a transaction or event be at least probable of occurring?
- 1.5(h) Is it likely that users that are interested in the transaction, event, or balance can obtain information directly from management that can reasonably satisfy the objective of the guidance?

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1.5(i) Is the lag between the year-end reporting date and the date financial statements are issued and made available to users likely to significantly dilute the relevance of the information resulting from the guidance?

Do you believe that the questions listed above are necessary for considering alternatives for private companies within recognition and measurement guidance? Or are the other questions in paragraph 1.5 sufficient for considering when alternative recognition and measurement guidance is appropriate for private companies within U.S. GAAP?

We believe that the questions currently included in 1.5 are reasonable. However, we believe the PCC and the Board should gather input from users of private company financial statements on how the questions above affect their consideration of transactions in private company financial statements.

Question 7: Do you agree that a private company generally should be eligible to select the alternatives within recognition or measurement guidance that it deems appropriate to apply without being required to apply all alternatives available to private companies within recognition and measurement? Do you agree that, in certain circumstances, the Board and the PCC may link eligibility for application of alternatives within recognition or measurement in one area to the application in another area? If not, why?

As stated in our cover letter, we generally believe that recognition and measurement differences should be developed carefully, with a focus first (as the proposed framework suggests in 1.2 of the ITC) on practical expedients. The ability to pick and choose alternatives in recognition and measurement that are fundamentally different from public company reporting could create greater diversity in financial reporting and could reduce comparability of a private company's financial statements with those of public companies and other private companies.