CUNA REGULATORY ADVOCACY
CUNA REGULATORY COMMENT CALL

September 14, 2012

FASB request for Comment: Private Company Decision-Making Framework

EXECUTIVE SUMMARY

- The Financial Accounting Standards Board (FASB) issued a request for comment on a staff paper that outlines an approach for deciding whether and when to modify U.S. Generally Accepted Accounting Principles (GAAP) for private companies, including credit unions.
- The request for comment contains initial FASB staff recommendations of criteria to determine whether and in what circumstances it is appropriate to adjust financial reporting requirements for private companies following GAAP. The purpose of the request for comment is to gather input from interested stakeholders about the appropriateness, completeness, and cost-effectiveness of the initial draft framework.
- The request for comment contains preliminary FASB staff recommendations that reflect what stakeholders have told the staff about their experiences using, preparing, auditing, reviewing, and compiling private company financial statements. The FASB decided not to deliberate the topics in the request for comment until stakeholders have provided input on the staff's preliminary recommendations, and the chairman and all members of the Private Company Council (PCC) have been appointed. At that time, FASB and the PCC will jointly reach tentative conclusions about the criteria to be included in the framework.
- The request for comment seeks input on the following six factors that differentiate the financial reporting considerations of private companies from public companies: types and number of financial statement users; access to management; investment strategies; ownership and capital structures; accounting resources; and learning about new financial reporting guidance.
- In addition, the request for comment seeks stakeholder feedback on the following five areas where financial accounting and reporting guidance might differ for private and public companies: recognition and measurement; disclosures; display (presentation); effective dates; and transition methods.
- FASB is accepting public comments until October 31, 2012. **Please send your comments to CUNA by October 19.**

Please send comments to Senior Vice President and Deputy General Counsel Mary Dunn and Assistant General Counsel Luke Martone. Click here for the request for comment.

BACKGROUND

The Financial Accounting Standards Board (FASB) issued a request for comment on a staff paper that outlines an approach for deciding whether and when to modify U.S. Generally Accepted Accounting Principles (GAAP) for private companies, including credit unions. The request for comment contains initial FASB staff recommendations of criteria to determine whether and in what circumstances it is appropriate to adjust financial reporting requirements for private companies following GAAP. The purpose of the request for comment is to gather input from interested stakeholders about the appropriateness, completeness, and cost-effectiveness of the initial draft framework.

The Financial Accounting Foundation recently established the Private Company Council (PCC) to identify issues in GAAP related to private companies and work with FASB on ongoing private company issues. The PCC and FASB will deliberate on feedback received on the request for comment, and together will determine the criteria the decision-making framework will contain.

The PCC would then identify, deliberate, and vote on any proposed changes, which will be subject to endorsement by FASB and submitted for public comment before being incorporated into GAAP. The PCC also will advise FASB on the appropriate treatment for private companies for items under active consideration on FASB's technical agenda.

DESCRIPTION OF REQUEST FOR COMMENT

The request for comment contains preliminary FASB staff recommendations that reflect what stakeholders have told the staff about their experiences using, preparing, auditing, reviewing, and compiling private company financial statements. FASB decided not to deliberate the topics in the request for comment until stakeholders have provided input on staff's recommendations, and the members of the PCC have been appointed. At that time, FASB and the PCC will reach tentative conclusions about the criteria to be included in the framework.

The request for comment seeks input on the following six factors that differentiate the financial reporting considerations of private companies from public companies:

- Types and number of financial statement users;
- Access to management;
- Investment strategies;
- Ownership and capital structures;
- Accounting resources; and
- Learning about new financial reporting guidance.

In addition, the request for comment seeks stakeholder feedback on the following five areas where financial accounting and reporting guidance might differ for private and public companies:

- Recognition and measurement;
- Disclosures;
- Display (presentation);
- Effective dates; and
- Transition methods.

Following are the recommendations of FASB staff, as outlined in the staff paper.

1) Determining Recognition and Measurement Guidance

The purpose of the preliminary staff recommendations on recognition and measurement is to assist FASB and the PCC in assessing whether, for existing and proposed standards under consideration, a sufficient basis exists to provide recognition or measurement guidance for private companies that differs from the related guidance for public companies. While applying the recommended factors may provide insights about potential alternatives, the purpose is not to reach conclusions about what the alternative method(s) of recognition or measurement should be for private companies if FASB and the PCC decide to provide alternative guidance in a particular standard. The FASB and the PCC would consider the benefits and costs of potential alternatives following due process that includes research, targeted outreach to stakeholders, and a public comment period.

The FASB and the PCC should first 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 to 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. If the guidance provides relevant information, FASB and the PCC should first 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. This request for comment uses the term *practical expedient* to mean a more cost-effective way of achieving the same or a similar accounting or reporting objective.

If FASB 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 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 including exceptions or modifications to guidance.

Analyzing Benefits and Costs

In analyzing benefits and costs, FASB and the PCC should take into account specific questions, including those listed below, to the extent each is pertinent to the issue under consideration. Some of the questions would be most applicable when FASB and the PCC are reconsidering the benefits and costs of existing guidance, while other questions would be most applicable when evaluating new guidance being deliberated for projects on FASB's current agenda.

Relevance to users: The first group of questions pertains to the relevance of information to typical users of private company financial statements and the access that those users commonly have to the relevant information, as follows:

a. Does the transaction, event, or balance significantly affect borrowings, liquidity, or leverage?
b. 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?
c. 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.
d. Is the primary purpose of the guidance to provide information about historical events and transactions rather than to provide information with predictive value to help users in making their forecasts of future cash flows?
e. Does the guidance require that the threshold for recognizing or measuring a transaction or event be at least probable of occurring?
f. Does the guidance relate to loss contingencies or commitments that could significantly affect future cash flows? If yes, consider whether disclosing the event or circumstance would likely satisfy the needs of users.
g. 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?
h. Is an untimely issuance of financial statements likely to significantly dilute the relevance of the information resulting from the guidance?

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

a. Does application of the guidance often require assistance from outside resources at a significant cost?
b. Is significant complexity involved in determining the initial and/or ongoing accounting treatment?
c. Are there expected to be significant changes to information systems, debt covenant agreements, other contracts, internal controls, or processes as a result of applying the new guidance?
d. Is the accounting treatment challenging to audit, review, or compile?

Other considerations: In evaluating these questions, FASB and the PCC should place more weight on the overall responses to questions relating to relevance to users. They generally should place a lesser—but still significant—weight on the overall responses to questions relating to cost and complexity.

The FASB and the PCC should not provide exceptions or modifications for private companies when recognizing or measuring the type of information that typical users of private company financial statements commonly focus on. No exceptions or modifications should be considered unless input from users indicates that a difference or change is appropriate. In evaluating potential exceptions or modifications, FASB and the PCC should consider the cost of providing the information—both in terms of the cost incurred by the preparer and the efforts that users may spend to adjust financial statements by substituting an alternative accounting method that may produce a result that they consider more relevant.

As FASB and the PCC evaluate potential exceptions or modifications, 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 FASB and the PCC limit exceptions or modifications to those areas of GAAP that do not have broad or significant relevance to typical users of private company financial statements, relatively few users are expected to need to access management to obtain the information for which exceptions or modifications have been applied.

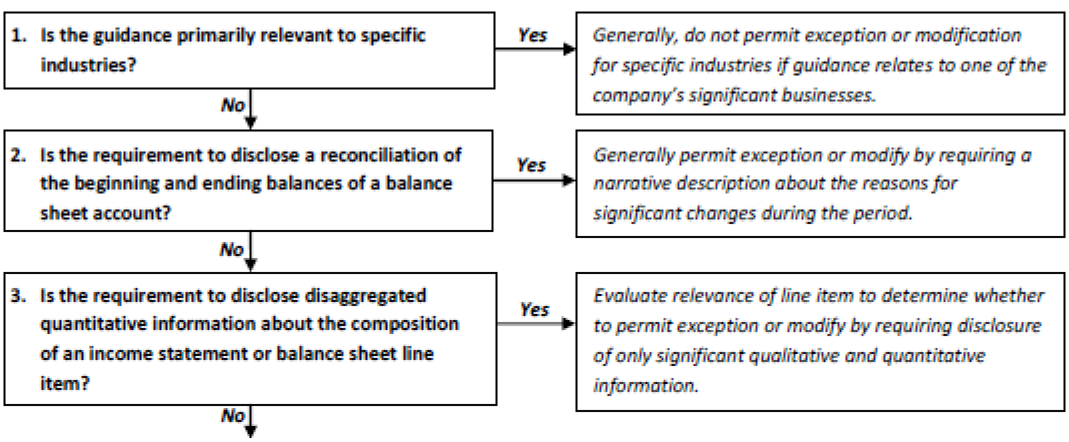
A private company that applies differences in recognition or measurement guidance should be required to disclose that fact prominently in the notes to financial statements to help users of its financials understand that one or more areas of the company's financials are not presented on a comparable basis with those of public companies.

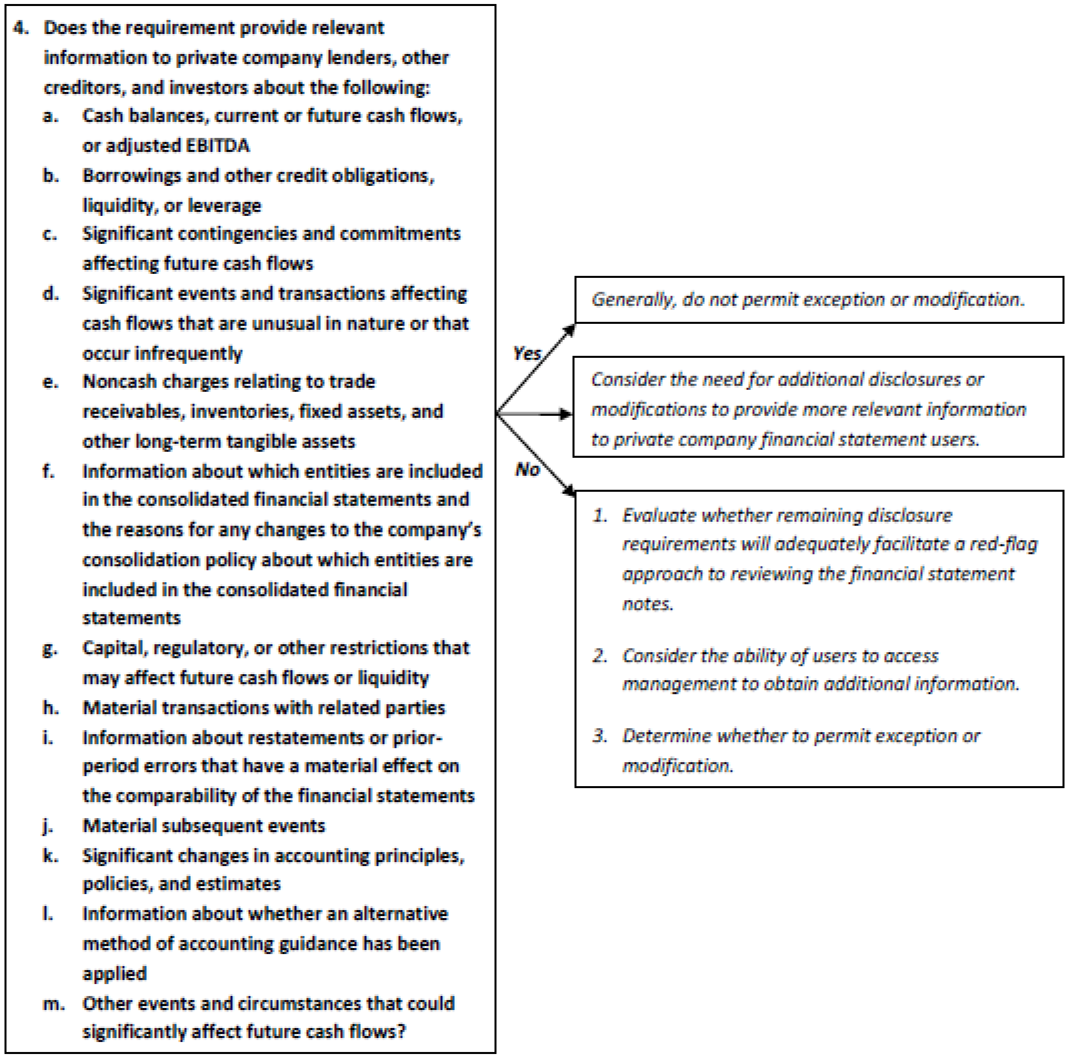
2) Determining Disclosure Requirements

In assessing whether to provide private companies exceptions or modifications for disclosures required of public companies, FASB and the PCC should first determine whether the disclosure provides relevant information to the most common types of users of private company financial statements. If FASB and the PCC determine that a disclosure provides relevant information to typical users of private company financial statements at a reasonable cost, generally no exception or modification should be considered.

Generally, FASB and the PCC should require private companies to provide the same disclosures as public companies for industry-specific accounting guidance that relates to one of a private company's significant businesses because of the presumption that, generally, industry-specific disclosures are relevant to financial statement users of both public companies and private companies operating in those industries.

In deciding whether to provide disclosure exceptions or modifications, FASB and the PCC should consider the following:





(FASB Process Flowchart for determining disclosure requirements)

As FASB and the PCC evaluate potential exceptions or modifications to disclosure requirements, 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. However, generally no disclosure exceptions or modifications 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. In evaluating disclosure exceptions or modifications, FASB and the PCC should consider whether the remaining disclosure requirements would adequately facilitate the red-flag approach applied by many users of private company financial statements in reviewing the notes to financial statements.

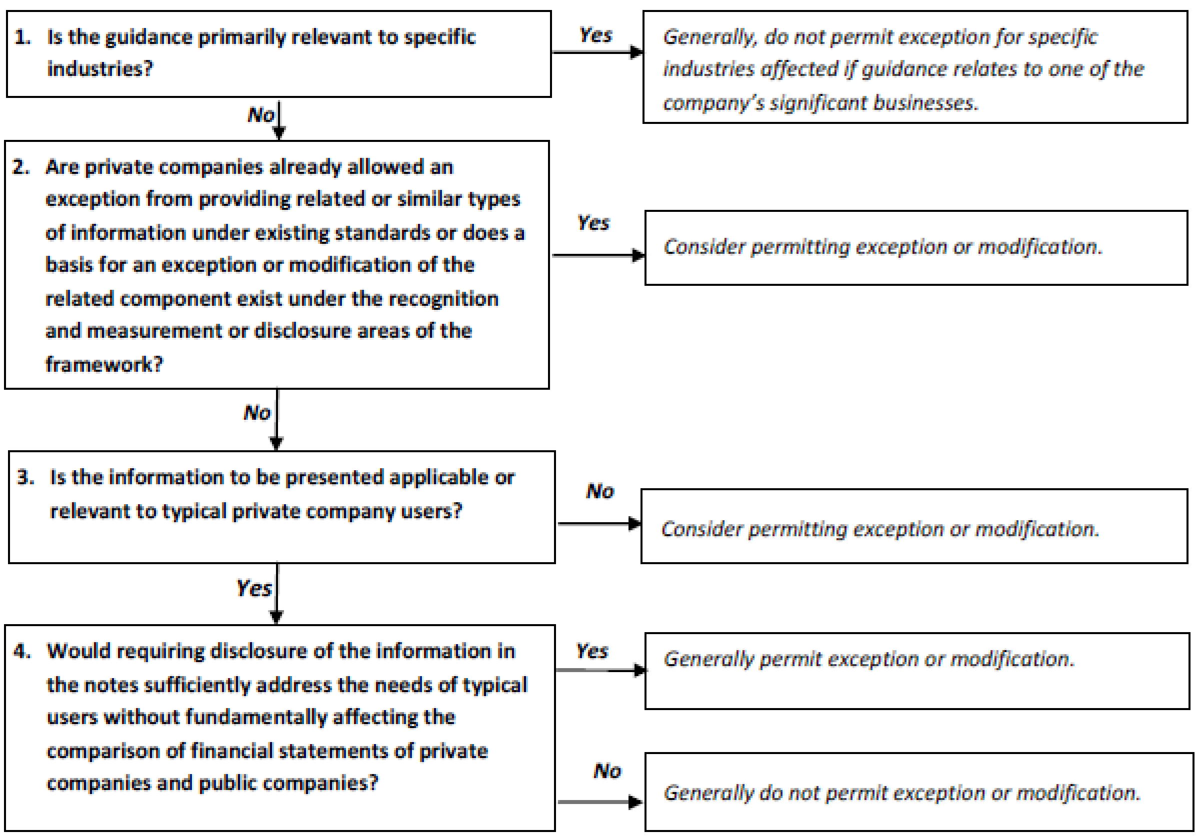
In light of the typical information needs of users of private company financial statements, FASB and the PCC also should consider whether private companies should provide additional disclosures beyond those required by public companies or whether modified disclosures would provide more relevant information to typical users of private company financial statements.

3) Determining Display Requirements

Generally, both private companies and public companies should apply the same financial statement display (presentation) guidance established by FASB 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, FASB and the PCC may conclude that private companies should be provided exceptions from applying the same display requirements as public companies or should apply a modified display requirement. In determining whether to permit a display exception or modification, FASB and the PCC should assess, among other pertinent considerations, if the information to be displayed is not relevant to typical users of private company financial statements, or does not apply to private companies, or if 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.

Generally, FASB and the PCC should require that private companies apply the same display requirements as public companies for industry-specific accounting guidance that relates to one of their significant businesses because of the presumption that the information required to be displayed for specific industries is relevant to financial statement users of both public companies and private companies operating in those industries.

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



(FASB Process Flowchart for determining display requirements)

4) Determining the Effective Date of Guidance

Because of their learning cycle and resource limitations, generally, the amendments in an 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.

For the same reasons above, 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.

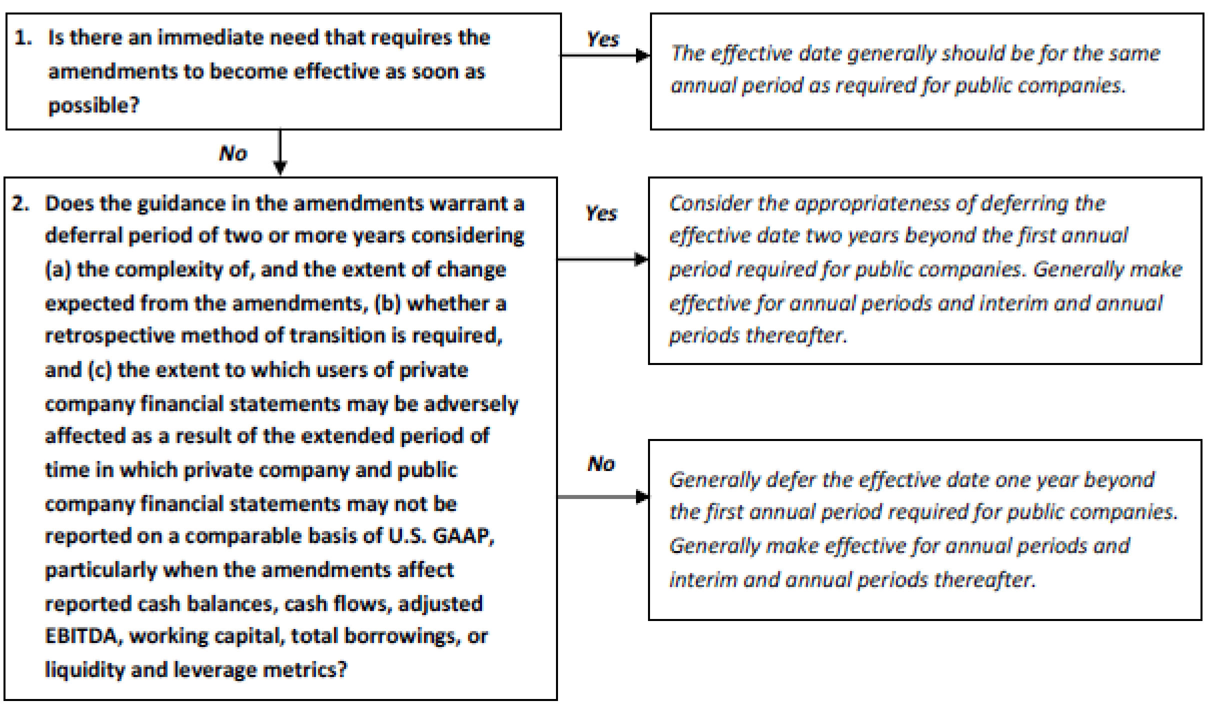
In determining whether the effective date for private companies should be the same as the first annual period required for public companies, FASB and the PCC should consider whether there is an immediate need for the amendments to become effective. In making that determination, FASB and the PCC should consider whether the amendments are being issued to (a) correct or clarify existing guidance that currently 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.

In determining whether the effective date for private companies should be more than one year after the first annual period required for public companies, FASB 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 non-comparability 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.

In assessing the complexity of the amendments, FASB 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.

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.



(FASB Process Flowchart for determining the effective date of the guidance)

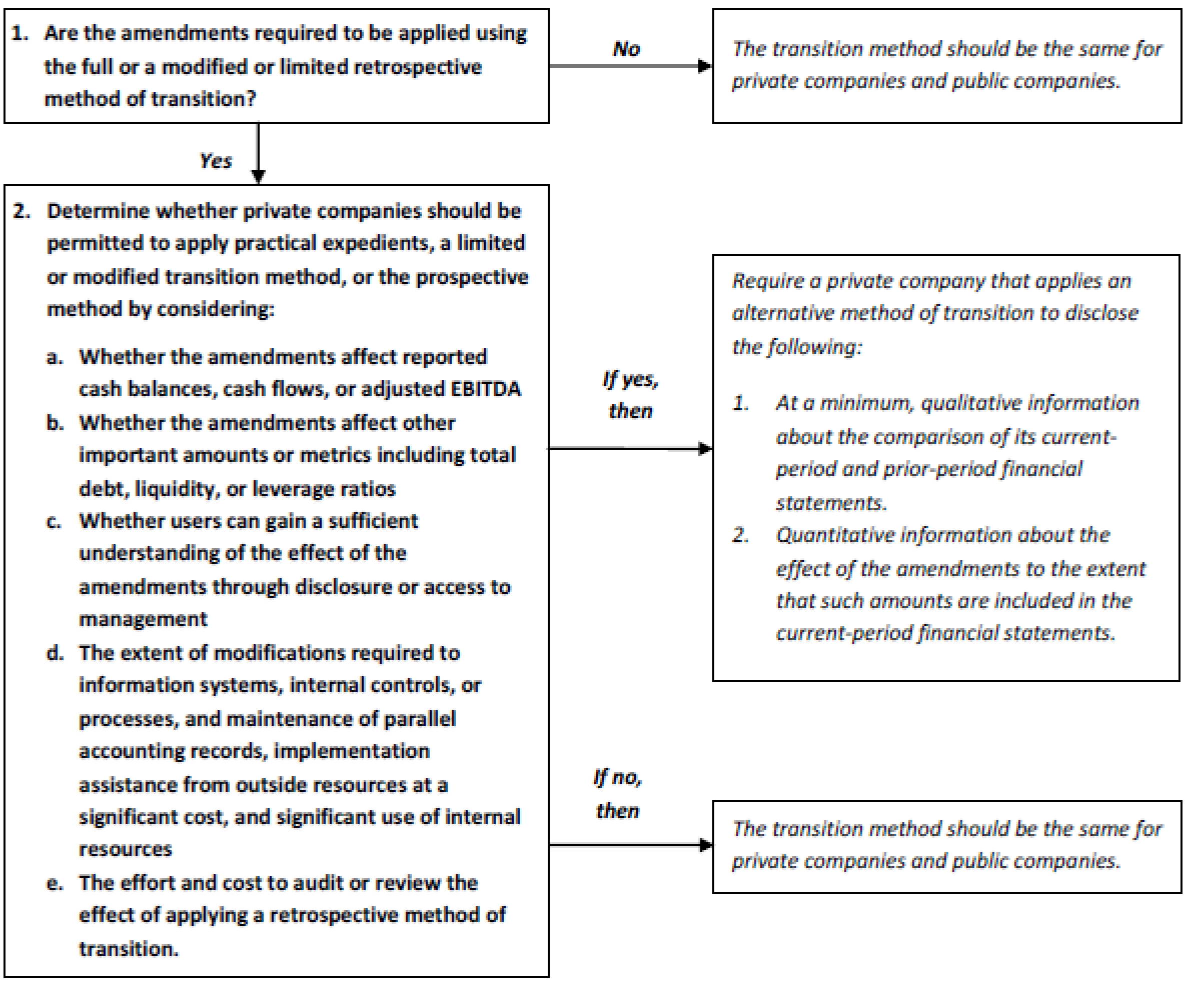
5) Determining the Transition Method for Applying Guidance

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

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

A private company should be required to disclose in the notes to financial statements if 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. A private company also should disclose quantitative information about the effect of the amendments to the extent that those amounts are included in the current-period financial statements.

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



(FASB Process Flowchart for determining the transition method for applying guidance)

In analyzing the benefits and costs of permitting an alternative transition method, FASB 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 preparers and users of 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.

Appendix B: Definition of a Nonpublic Entity

In a separate but related project to define a "nonpublic entity," FASB is deliberating which types of companies would be included in the scope of the private company decision-making framework. The FASB's tentative decisions reached to date about the types of companies and organizations in the scope of the framework are included in an appendix to the request for comment. However, FASB expects that not all types of entities that would be included in the scope of the framework would be eligible to apply every exception and modification provided by FASB and the PCC. For example, the specialized accounting practices followed by companies in certain industries. The FASB plans to expose the proposed definition of a nonpublic entity for public comment and discuss the stakeholder input received with the PCC before finalizing its decisions.

Tentative Decisions Reached to Date

The FASB has tentatively decided that an entity is not a private company if it:

- 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;
- Is a for-profit conduit bond obligor for conduit debt securities that are traded in a public market; or
- Is an employee benefit plan.

The FASB separately considered the following types of entities and tentatively decided that they are not excluded from the definition of a private company unless they meet any of the characteristics described above:

- A financial institution;
- A consolidated subsidiary of an entity that is a public company; and
- An entity that has a controlled and consolidated subsidiary that is a public company.

Financial Institutions

The FASB discussed whether a financial institution that otherwise meets the characteristics of a private company should be included in the definition of a private company for financial reporting purposes and, therefore, would be within the scope of the private company decision-making framework. A financial institution referred to in the definition of a private company includes banks, saving and loan associations, savings banks, credit unions, finance companies, and insurance entities.

The FASB discussed whether to exclude all financial institutions from the definition of a private company on the basis of the notion of public accountability because privately held financial institutions hold and manage financial resources for a broad group of individuals for investment purposes. The FASB rejected that alternative because of its view that the notion of public accountability applies to many regulated industries and should not be a factor in determining whether an entity is considered private for financial reporting purposes.

Some FASB members expressed concern that if financial institutions were considered private companies and within the scope of the private company decision-making framework, it may not always be appropriate for those companies to apply differences in GAAP because of the unique needs of some financial statement users of financial institutions. The FASB determined that a financial institution could be considered within the definition of a private company, but could be excluded from the scope for specific exceptions or modifications provided for private companies if it is determined that those differences would adversely affect the relevance of information provided to financial statement users. The FASB decided that a privately held financial institution could be considered for exceptions and modifications in areas of accounting and reporting that are not specific to financial institutions or that are not particularly relevant to financial statement users of financial institutions.

Some FASB members expressed support for excluding financial institutions entirely from the definition of a private company because of their unique nature but are continuing to evaluate whether financial institutions should be permitted to apply accounting and reporting differences when deliberating individual topics. Those FASB members stated that the needs and investment strategies of financial statement users of financial institutions, including depositors and regulators, may differ from the needs of most other users of private company financial statements and, therefore, may require separate consideration depending on the accounting or reporting difference under consideration.

One FASB member expressed concern about additional costs that could be incurred by financial institutions if regulators do not accept differences in accounting and reporting guidance for private companies. As a result, financial institutions may be required to maintain two sets of accounting records, which may not be cost beneficial.

The FASB considered an alternative that would differentiate financial institutions on the basis of asset size. The FASB rejected that alternative because it would be difficult to determine a bright line on the basis of the size of a financial institution when assessing user needs and preparer considerations. In addition, if FASB were to establish a size threshold to correspond with current thresholds created by regulators, those thresholds would be subject to change by the regulators during future periods, which would require FASB to consider whether to make a corresponding change.

The FASB has not yet deliberated all of the topics to be addressed to finalize the definition of a private company, including the method of transition and effective date.

QUESTIONS TO CONSIDER

1) Has the staff identified and focused on the appropriate differential factors between private companies and public companies? If it has 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.

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2) Overall, do the staff recommendations result in a framework that would lead to decisions that provide relevant information to users of private company financial statements in a more cost-effective manner? If they do not, what improvements can be made to achieve those objectives?

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3) Do you agree that private companies that apply industry-specific accounting guidance generally should follow the same industry-specific guidance that public companies are required to follow because of the presumption that guidance is relevant to financial statement users of both public companies and private companies operating in those industries? If not, why?

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4) Do the different areas of the framework 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 area of the framework appropriately describe the *red-flag approach* often used by users when reviewing private company financial statements? If not, why?

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5) Has the staff identified the appropriate questions for FASB and the PCC to consider in the recognition and measurement area of the framework? If it has not, why, and what additional factors should be considered?

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6) Has the staff identified the appropriate areas of disclosure focus by private company financial statement users for FASB and the PCC to consider? If it has not, why, and what are those additional areas?

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7) Do you agree that, generally, private companies should apply the same display guidance as public companies? If not, why?

8) Do you agree that, generally, private companies should be provided a one-year deferral beyond the first annual period required for public companies to adopt new guidance? If private companies are provided a deferred effective date, do you agree that a private company should have the option to adopt the amendments before the deferred effective date for private companies but no earlier than the required or permitted date for public companies? If not, why?

9) Do you agree with the staff recommendation that some circumstances may warrant consideration of different transition methods for private companies? If yes, has the staff identified the appropriate considerations for FASB and the PCC to evaluate? If not, what additional factors should be considered?

10) Do you agree with the basis for FASB's tentative decisions reached to date about which types of companies should be included in the scope of the framework? If not, why?

11) Some users of private company financial statements stated that they prefer an *all or nothing* approach of applying recognition and measurement differences to achieve consistency within a private company's financial statements and promote comparability among the financial statements of private companies that choose to apply all exceptions and modifications provided under the framework. Those users indicated that such an approach would reduce confusion if private companies are allowed to select which differences they apply. Users acknowledged that the extent of that confusion will depend on the number of recognition and measurement differences that are ultimately permitted and the nature of those differences. However, most users stated that they do not object to allowing private companies the option of applying some, none, or all of the permitted differences in disclosure, display, effective date, and transition method guidance.

Most preparers of private company financial statements acknowledged the concerns of some users, but stated that preparers should be allowed an option to select the differences provided under the framework that they wish to apply. Those preparers pointed to the possibility that not every permitted difference in recognition and measurement guidance may provide the most relevant information to users of their financial statements or for the companies operating in their industry. Some preparers also shared concerns about being required to make an initial commitment to apply all future differences permitted under the framework without knowing the nature or volume of the recognition and measurement differences that FASB and the PCC may ultimately provide.

a) Do you think that a private company that elects to apply any difference in recognition or measurement guidance should be required to apply all such existing and future differences?

b) Do you think that a private company should have the option to choose which differences it applies in all other areas of the framework (disclosure, display, effective date, and transition method)?

12) Any other comments or questions.