The Private Company Council's Effect on Your Privately-Held Company's Financial Statements

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April 2015 -- As a standard practice, many of our Firm's small, medium-sized, and larger privately-held companies are required to adhere to accounting and reporting rules established by the Financial Accounting Standards Board (FASB), if they issue financial statements in accordance with U.S. Generally Accepted Accounting Principles (US GAAP). These rules are, in effect, the same as those followed by multi-national public companies, such as PepsiCo and General Motors. Because of the significant burden on privately-held companies, in terms of the time and expense associated with ensuring that financial statements are in compliance, there are a variety of financial statement reports that are issued with US GAAP "departures." When dealing with bank financial reporting requirements, these reports may not be acceptable.

In an effort to understand the differences between publicly-held and privately-held companies with regard to financial statements, the American Institute of Certified Public Accountants, the Financial Accounting Foundation (the parent organization of the FASB), and the National Association of State Boards of Accountancy created a panel. One of the panel's key priorities was to address how existing accounting standards could more effectively meet the limited resources and needs of privately-held companies. One recommendation from the panel was the formation of the Private Company Council (PCC). Established in May of 2012, with the approval of the Financial Accounting Foundation's Board of Trustees, the PCC's main responsibility was to improve the process of setting accounting standards for privately-held companies.

The PCC took on two specific areas that could potentially impact many of our Firm's clients. The result was that FASB, based on issues identified by the PCC, issued *Accounting Standards Updates* that provide significant alternatives to US GAAP, and have given privately-held companies the ability to issue US GAAP financial statements. The two specific areas are "Accounting for Goodwill" and "Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements."

Under US GAAP, Goodwill related to a business combination is subject to an impairment evaluation on an annual basis (or more frequently, if conditions warrant); this evaluation involves a fairly complicated two-step calculation. The PCC recommended, through a FASB *Accounting Standards Update*, the allowance of an alternative for privately-held companies: that Goodwill can be amortized on a straight-line basis over 10 years (or less, if another useful life is more appropriate). Under the alternative, Goodwill must be tested for impairment, if a triggering event occurs that indicates that the value of the Goodwill may be less than its carrying value. By taking advantage of this alternative, privately-held companies do not have to perform the two-step impairment calculation, and the risk of impairment decreases as the net carrying value of the Goodwill decreases due to the amortization.

One contentious issue for privately-held companies related to the requirement of consolidating a lessor entity under common control, due to the compliance cost of Variable Interest Entity (VIE) reporting. For this reason, many privately-held companies issued financial statements that included a US GAAP departure, instead of issuing consolidated financial statements. US GAAP requires the consolidation of an entity in which a company has a controlling financial interest, such as when a reporting entity is deemed to have the power to direct the activities of another entity, and the obligation to absorb the losses or the right to receive the benefits of the other entity. This situation is most common when an operating entity leases facilities from another entity under common ownership.

The PCC and FASB approved an alternative that exempts privately-held companies from applying the VIE guidance to a lessor entity (where it would be required to consolidate):

- if the two entities are under common control,
- if there is a lease between the two entities,
- if substantially all the activities of the two entities are related to leasing,
- and if the reporting entity provides guarantees or collateral to the lessor entity.

Although the disclosure requirements include details of the arrangements between the two entities as well as the amounts at risk for the reporting entity, privately-held companies can now issue financial statements with no US GAAP departures.

The PCC has announced other amendments that have been incorporated into US GAAP through the issuance of *Accounting Standards Updates*, many of which have helped alleviate the reporting difficulties often faced by privately-held companies. Additional amendments are forthcoming. If you would like to gain a better understanding of how the PCC's activities may affect your company's financial statements, we would be happy to meet with you and answer any questions you might have. Please do not hesitate to contact us.

Jennifer Barliant has over 25 years of public accounting and tax experience, working with companies and their owners within the middle market. As an Accounting & Audit Partner, she focuses on providing audits, reviews, and compilations of financial statements. Jennifer's industry experience includes manufacturing, professional service providers, associations and not-for-profit organizations, investment partnerships, retailers, and the graphic arts. She also performs employee benefit plan audits.