



financial executives
international

COMMITTEE ON PRIVATE COMPANY STANDARDS

January 13, 2012

John J. Brennan
Chairman, Financial Accounting Foundation
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Brennan:

The Committee on Private Company Standards (CPC-S) of Financial Executives International (FEI) wishes to express its views on efforts made to address private company issues, particularly on the FAF's *Plan to Establish The Private Company Standards Improvement Council (PCSIC)*. FEI is the leading advocate for the views of corporate financial management in the United States. It is a professional association of more than 15,000 CFOs, treasurers, controllers and other senior financial managers, approximately half of whom work for private companies. CPC-S is a technical committee of FEI which formulates private company positions for FEI in line with the views of the membership. This letter represents the views of CPC-S and not necessarily the views of FEI.

Our committee has been debating the relative merits of the existing standard setting process for private company standards for a number of years. As a committee, we do not always agree on every detail. However, we are unanimous in our support for improvement in the standard setting process with respect to private companies. We also are unanimous in our views on some of the main concerns that need to be addressed.

In the last year, we have noticed substantial improvement in the approach the FASB has taken with respect to private company issues and we have noted the process changes underway to address private company concerns by improving the existing processes. We also recognize and appreciate the attention the Board of Trustees of FAF has placed on private company concerns. We believe the proposed PCSIC is a logical step in the evolution of the standard setting process.

While we agree with the general idea of the PCSIC, we would like to suggest improvements to the FAF's plan that may address our concerns. Our largest concerns are:

1. As proposals for private company alternatives are addressed by a group focused on private company issues, there should be a high hurdle for those proposals to not be ratified (i.e. regarding a FASB veto).
2. The group that addresses private company standards should be allowed to set its own agenda.
3. Any changes to the structure of the standard setting process to address private company concerns should incorporate enough checks and balances to allow the new process to be effective regardless of the individuals on the PCSIC or FASB.
4. The effort to address future GAAP proposals as well as a review of existing GAAP will require significant time and effort and may require some form of remuneration.
5. The PCSIC should be sized in a way that allows it to reach timely and well informed decisions.
6. It will be important for the PCSIC to develop a conceptual framework to guide its decision making process.
7. FAF should take an active part in monitoring the effectiveness of any changes as part of its governance role over the standard setting bodies.

High Hurdle not to Adopt PCSIC Proposals (the FASB Veto)

The potential FASB veto of a PCSIC proposal is the most polarizing issue in the debate. We hope it is the most unwarranted issue. On one side of the argument, some believe that the FASB has not made private company exceptions in the past when it had the ability to do so and therefore it will not change its mind and approve exceptions (at least to existing GAAP) in the future. On the other side of the argument, some believe that the private company issues may not have been fully addressed when existing standards were issued and that the FASB is not going to ignore sound reasoning and well-articulated arguments for exceptions going forward.

There are two extremes posted in the FAF's Plan: - either the FASB must approve or veto PCSIC proposals or the FASB has no ability to review PCSIC proposals. However, we believe there are many alternatives that are between the two extremes.

In the first extreme, if the FASB is required to consider whether to ratify all PCSIC proposals, the FASB could stand in the way of improvements supported by a unanimous PCSIC. That is the structure of the proposal even if it is not intended to function that way in practice. Again, if the desired practice is different than the structure, the structure is not meaningful. We believe the FAF's idea in concept is that the FASB and PCSIC will work together to craft proposals. If that is true, we believe it would be more beneficial to have the structure reflect the idea of combined support for a proposal and collaborative cooperation.

In the other extreme, if it is true that private company concerns were not adequately addressed in the past due to lack of input, resources or time constraints, then the requirement for FASB ratification is redundant. Under this extreme, the FASB would accept the PCSIC proposals. In this extreme, it is not the exception that is objectionable, it was a failure to address the private company concern at the time the standard was being deliberated.

Under either extreme, we believe that the PCSIC and FASB must work together in a collaborative way. Creating any standard setting group that does not work well with other standard setting groups will hurt the overall standard setting process, will injure the accounting profession and be a disservice to the users of both public and private company financial statements.

Neither extreme reflects how we think the PCSIC and FASB would work together. For that reason, we feel the proposed structure of the PCSIC should incorporate some version of forced collaboration. Some parts of the proposal tend to hurt required cooperation, such as requiring a FASB member as the Chair of the PCSIC. If the FASB has to ratify the proposals, having a FASB Chair the PCSIC is not necessary. Some additional alternatives might include:

- Adding additional FASB members to the PCSIC
- Requiring a majority of combined PCSIC and FASB votes to ratify a PCSIC proposal
- Requiring a unanimous vote by the FASB to veto a PCSIC proposal
- Having a non-FASB Chair of the PCSIC

We believe that the PCSIC and FASB will have to work together to achieve high quality standards for all constituents. We believe that is the FAF's intent and that is their expectation of the existing FASB. The PCSIC structure should be changed to institutionalize this concept in some way. The current proposal seems to leave too much weight on the FASB side of the equation which is currently divisive. Some compromise position to allow the technical structure to be more aligned with the expectation of the parties would improve the overall structure and the credibility of the PCSIC's abilities. The PCSIC should be viewed as a group that can address controversial issues and achieve meaningful results, and remain accountable to the FAF, without unnecessary impediments by the FASB.

Setting Its Own Agenda

While not specifically addressed, we have a concern that any new group should be able to address issues it feels will lead to an improved set of standards for private company constituents. Specifically, if there were ever issues where the PCSIC and the FASB disagree, the PCSIC should still be able to debate and propose changes. There seems to be a concern among many private company constituents that the PCSIC, as proposed, would not be able to address certain concerns that it feels are significant if it does not have control of its own agenda.

If the agenda were controlled in such a way to limit the PCSIC's ability to address certain sensitive issues, that structure would not accomplish the FAF's goals for creating the PCSIC as we understand them. If controversial issues have helped create the problems we have today, addressing those issues will help resolve the problems and there should not be structural impediments to addressing the issues. Recognition and measurement exceptions to GAAP for private companies, in addition to disclosure simplification may be rare, but there may be instances where they are warranted. It would be better for the PCSIC and FASB to disagree on an issue after debate than to allow the issue to go unaddressed.

If the PCSIC cannot control its own agenda, its credibility may suffer whether that is warranted or not. If a FASB member controls the agenda on paper (the structure proposed) but in reality the internal process allows any item to be addressed and no issue is off limits, the structural limitation on agenda setting will not serve any purpose.

In addition, one of our concerns we will address later is that any changes should survive the personalities present on either the PCSIC or FASB and become part of the institution of standard setting. We believe that allowing an individual to set the agenda for the PCSIC, rather than the PCSIC itself, would not give the PCSIC the independence it needs to be the most credible group to address private company concerns.

For the credibility of the PCSIC and to further institutionalize the changes taking place, we believe the PCSIC should specifically be granted the authority to control its agenda.

A Process that Survives People and Personalities

The FASB as an institution should be able to operate consistently over time regardless of its staff or board members. Similarly, the PCSIC should be able to consistently participate in the standard setting process for private companies regardless of its members.

Some of our members believe that the current PCSIC proposal would not have been possible a few years ago. Some also believe that the proposal would not have been needed at other points in the FASB's existence. However, as the financial world changes, organizations and standard setters need to evolve to address the changing circumstances. That ability to change must be institutionalized and not depend on any individual or personality. For that reason, it is important to get the technical structure as close to the functional ideal way as possible. FAF should imagine the best functioning standard setting groups and write the structure to support that ideal state.

Ultimately, if this contemplation of the ideal working relationship is used to create the governance structure of how the two groups will work together, it will be a guide into the mindset of the Board

of Trustees. While we appreciate the thought that went into the PCSIC proposal, some items in the Plan (such as the FASB veto and agenda setting) may have been addressing more practical concerns rather than acting as a roadmap for how the two groups should function together. The goal is to have well-functioning groups where the governance structure is designed to support, not to inhibit, achieving the highest quality standards, and specifically in this case, the highest quality standards for private companies. Specifically, we feel the issues of the FASB veto and the agenda setting will require the most collaboration and therefore, those two issues require more formalized collaboration in the governance structure of the groups. The proposed structure is one sided in allowing a sitting FASB member to set the agenda and allowing the FASB to consider the proposals of the PCSIC as they would the proposals of any FASB staff member.

When an organization works well together, a structure that requires collaboration is transparent and would seem redundant. In organizations that do not work well together, a structure that requires collaboration will support the need for mutual cooperation to achieve results.

Significant Time Requirement

If anyone were to keep up with the existing standard setting process and independently evaluate every proposal's impact on their business, the time required would be significant. We believe it would be difficult for a group that meets for a short period six times a year, as proposed by the FAF Plan for the PCSIC, to stay briefed on existing projects, with a goal toward developing, deliberating, and finalizing tangible improvements to GAAP for private companies, let alone considering the time it would take to consider the body of existing GAAP and current FASB projects.

It will be important that the PCSIC issue some proposals quickly, at least within the first year. The issues the PCSIC will be dealing with are not easy to resolve.

For these reasons, we believe the time expected of PCSIC members should be increased. We believe it may take up to 40 hours each month to stay current and begin to make slow progress in addressing some of the existing pain points that have led to the formation of the PCSIC. We also believe PCSIC members should devote some time to outreach to ensure they have a continuing connection to their private company constituents. It is possible that after a few years, this time requirement would diminish as FASB projects decrease and the most significant issues in existing GAAP are addressed by the PCSIC. However, initially there will be a significant time requirement to create a functioning group, build interpersonal relationships and address a number of pressing private company concerns.

The composition of the PCSIC will be challenging. Small organizations may not be able to spare an important individual for such a significant period of time. Large private organizations may not be able to spare individuals with other duties or expertise. It will take people who are experienced,

technically focused and willing to work on ambiguous projects through to completion. Those are the same characteristics organizations of all sizes seek to retain.

Remuneration of PCSIC members is also a concern. In some smaller organizations where the PCSIC member is an owner, remuneration may be needed to offset the diminished earnings of the individual due to PCSIC service. In other organizations, paying an employee who is also being paid a salary would be unusual and may cause issues with employee benefits such as pension or 401(k) contributions and possibly an impact on employee vacation. Additionally, conflict of interest policies at some companies may not allow an employee to receive pay from an outside organization and such employee may be reluctant to accept the pay directly.

We believe pay for service on the PCSIC should be allowed, considered and offered but not required as pay directly to the PCSIC member. All travel costs and other incremental costs should be reimbursed by FAF including travel and expenses related to approved outreach activities.

Size of the PCSIC

We believe the PCSIC should be made up of seven members. We believe the FAF was correct in its assessment of the working dynamics of the FASB when it increased the size to seven members in 2010. Having more members will add to the complexity of reaching a timely decision but recognize that having only seven members may limit the diversity of views presented, particularly by private companies of different sizes, with varying levels of complexity, funding models, and user needs. To improve the diversity of views present in a smaller group, we suggest having an advisory committee similar to the existing Small Business Advisory Committee (SBAC) or the Private Company Financial Reporting Committee (PCFRC) to advise the PCSIC and FASB and increase the input from the diverse constituencies.

Conceptual Framework

We believe the first priority of the PCSIC should be to establish a high level conceptual framework and begin working on it as a guide to making decisions. It will be important to begin the process of deliberating some of the issues as soon as possible but the PCSIC needs to have a well thought out way of making consistent decisions based on a conceptual framework.

We are aware that the FASB staff has been working on a conceptual framework for private company differential reporting and we urge that the documents be exposed as soon as they are available. If the documents are made available, more information will be publicly available and the overall knowledge of the issues will be increased which will improve the dialog. The documents do not need to be exposed with a specific action in mind, but comments should be encouraged.

The PCSIC can use the exposed conceptual framework and comments to begin its discussions with more insight and better information which should speed their decision making process.

FAF Oversight

We view the formation of the PCSIC as an evolutionary step in the standard setting process. It should be considered as the next step in the governance oversight process by FAF but one which leads to many steps to come. As the PCSIC is formed and is operating, we believe FAF should play an active role in monitoring the progress of the changes made. The FAF Board of Trustees should meet with PCSIC members as a group and individually to hear concerns about the governance and standard-setting process, as it should meet with members of the FASB. As part of its oversight role, the FAF Board of Trustees should also meet with the FASB's advisory groups as representatives of the constituencies being served to assess the effectiveness of the processes in place. Outreach, being more visible and asking more questions can improve the information available to the FAF Board of Trustees as it assesses the need for further evolutionary change.

Conclusion

We want to thank the FAF for your support of improvements to the private company standard setting process by developing the FAF Plan, and seeking public comment on that Plan. We are willing to help in any way by offering the advice and opinions of our members as a group or as individual companies representing a diverse group of sizes and industries. Our committee is always willing to meet with members of the Board of Trustees or its advisors to help communicate our views and further clarify our opinions. If you have any questions or wish to discuss this letter, please feel free to contact me at (704)365-7382 or by email at gwbeckwith@nationalgypsum.com, or Lorraine Malonza at FEI at (973) 765-1047 or by email at lmalonza@financialexecutives.org.

Sincerely,



George Beckwith, Chair
Committee on Private Company Standards
Financial Executives International

CC: Terri Polly, FAF President and CEO