Members of a blue-ribbon panel established to provide recommendations on the future of accounting standards for private companies met for the first time Monday to discuss their views on the topic, which has been debated for decades.

The key portion of the meeting featured the viewpoints of those panel members who use private company financial statements. Those users included three lenders, a venture capitalist, a private equity manager, a surety, and a business owner. One of the key takeaways was that most members agreed that U.S. GAAP is seen as a gold standard in financial reporting, and that consistency of GAAP is key.

They also said that financial statements are only a part of decision making and that management’s character plays an important role in those decisions.

The 18 panel members, including AICPA President and CEO Barry Melancon, and participating observers represent a cross-section of financial reporting constituencies, including lenders, investors and owners, as well as preparers, auditors and regulators. Rick Anderson, CEO of Moss Adams LLP, is the chairman.

It is sponsored by the AICPA; the Financial Accounting Foundation, FASB’s parent organization; and the National Association of State Boards of Accountancy.

**GAAP is gold, but just the start**

Most panel members agreed that GAAP is seen as the “gold standard.”

“Lenders [and other users of financial statements] want GAAP for validity, reliability and accuracy … tied to assurance,” said James Castellano, who is not a panel member but served as past chairman of the AICPA’s Private Company Financial Reporting Task Force and took part in an expert discussion Monday. “The notion that there’s a body of knowledge that is [universally] accepted is important.”

Panel members said in using financial statements, they make adjustments to fit their own needs and they would be willing to make further changes if GAAP were modified. But having too many exceptions and variances erodes the notion of what is considered to be generally accepted, they said.

“If the standard changed tomorrow, we’d adjust our own underwriting of that,” said Dev Strischek, panel member and senior vice president and senior credit policy officer, Corporate Risk Management, SunTrust Banks Inc. “We know we need to speak different languages for private vs. public companies, but one person’s flexibility is another person’s chaos. We’d prefer field hockey to lacrosse as a standard. Field hockey has boundaries.”

Panel members also stressed that while financial statements are an important element in decision-making by the users of those statements, they are a starting point and, after that, many other factors are considered, including the character and integrity of management.

Jason Mendelson, a panel member and managing director and co-founder of Boulder, Colo.-based venture capital firm Foundry Group, pointed to the key role the human element plays in decisions.
“This march to character is happening,” Mendelson said. “I now have monthly meetings with banks. They want my personal guarantee—my word—that I support this company, despite the fact they have all my financial statements. That says, if you’re wrong it may be difficult for you to obtain credit later.”

Panel member Michael Menzies, president and CEO of Easton Bank and Trust Company, a small community bank in eastern Maryland, said his bank only lends to relationships, so the borrower plays a bigger role than the financial statements do, though he values GAAP for making industry comparisons.

“We lend as if the borrower is going to marry our daughter,” Menzies said. “We get key information from walking around the business and kicking the tires.”

Several “C” factors come into play when making the analysis on whether to lend, including the capacity to repay debt, capital, collateral, the right conditions and adequate coverage to transfer out risk, he said.

Next steps

The group began to talk about the complexities related to standards but Anderson said that discussion likely will be expanded upon at the panel’s meeting next month, when preparers and auditors will share their viewpoints whereas Monday’s meeting focused on the viewpoints of the users of financial statements. Also at next month’s meeting, representatives from the International Accounting Standards Board and the Canadian Accounting Standards Board will speak with the panel about IFRS for SMEs and Canadian GAAP for Private Enterprises.

Judith O’Dell, chairman of FASB’s Private Company Financial Reporting Committee, will give a report on Canada’s progress with its private company financial reporting standards. She is one of the panel’s participating observers.

The meeting will take place on May 14 at the FAF’s office in Norwalk, Conn.

For now, the panel will focus on all organizations that don’t report to the SEC, with the exception of nonprofits, though banks and other types of companies may be excluded later, according to Anderson.

Anderson started Monday’s meeting by saying that he’s received several questions as to how this group will differ from others tasked with similar efforts in the past. He emphasized that what makes this panel stand out is that it includes representatives of all the key constituents of private company accounting and places a strong emphasis on financial statement user needs and viewpoints.

He stressed the fact that this panel is not about technical decisions, but process.

“The real issue is how do we get the right set of standards for users,” Anderson said. “This is not about any given standard. It’s easy to focus on the symptom—the symptom being a specific standard. We need to focus on whether the process is giving the right answers to companies, and if the answer is no, what would be a better solution.”

An archived recording of Monday’s meeting is available here.