Bridging the GAAP

How an alternative framework can streamline financial statements

INTERVIEWED BY ROGER VOZAR

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Help has arrived for small and midsize businesses burdened by preparing financial reports according to generally accepted accounting principles (GAAP). The American Institute of Certified Public Accountants (AICPA) released the Financial Reporting Framework for Small and Medium-Sized Entities (FRF for SMEs) to provide some relief.

"This has been on ongoing concern of privately-held companies for a long time," says Jim Suttie, CPA/ABV, a principal with Skoda Minotti. "There's been talk about separating what they call 'big GAAP' and 'little GAAP,' but no one knows when that will happen. So the AICPA stepped up to supply a new framework that saves owner-managed companies from a lot of compliance requirements."

Smart Business spoke with Suttie about the new framework and the benefits it provides for small and midsize businesses.

Are GAAP standards too cumbersome for small businesses?

They can be, depending on the situation. For a small to midsize business that is owner-managed, the cost and complexity of GAAP compliance can be quite a burden. What the FRF provides is an alternative, principles-based framework that can provide meaningful financial statements, while reducing unnecessary complexity and costs.

What makes GAAP reporting costly?

The cost comes from two different places — gathering the information and complying with the standards.

Take the example of an operating company that leases a building from an entity that is set up for tax purposes or estate planning purposes. The building is under a separate entity, but with common ownership. Under GAAP, those would have to be consolidated, so it adds a layer of complexity.

Another example is if there is goodwill on the books. Under GAAP, goodwill must be assessed for impairment — the difference between book and implied fair value — on at least an annual basis. With the FRF for SMEs, goodwill is treated the same way as it is for tax purposes; you amortize it over the life of the goodwill, which is 15 years.

Is there a size requirement for businesses to use this new framework?

It's not necessarily based on size; the AICPA intentionally did not set a quantitative limit. Typically, SMEs are owner-managed businesses. The preface of the FRF outlines characteristics of SMEs, including:

- For-profit businesses.
- No regulatory requirement to use GAAP.
- Users of the financial statement have direct access to the entity's management.
- The entity does not operate in an industry involved in transactions that require highly specialized accounting guidance.
- The entity is owner-managed.

The FRF is not applicable to companies that are public or have plans to go public.

Are there potential problems in switching from GAAP to the FRF?

One challenge is that the framework is not authoritative — although it has been subjected to public comment and professional scrutiny. In the AICPA's words, it has not been approved, disapproved, or otherwise acted upon by the AICPA or any authoritative body. There's also the challenge of third-party users, like banks and sureties, which require GAAP financial statements in their documentation. Accounting firms and others are trying to inform them that this is a viable alternative that may provide more meaningful information. In some instances, the FRF can give clearer information about a company's cash flow, liquidity and financial position than GAAP, which can sometimes muddy the waters with its complexity.

In the case of a variable interest entity in which a real estate company is consolidated with the operating company — the consolidated financial statements are given to the bank, which may separate the information on the real estate entity. So FRF can make the process more direct for third-party users.

But the biggest advantage of the new framework is with the company itself in the reduction in cost of compliance with GAAP. It just makes it easier to prepare financial statements.