2013

Alert : Understanding the financial reporting framework for small-and-medium-sized entities

American Institute of Certified Public Accountants (AICPA)

Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities

Special Purpose Frameworks for Non-GAAP Reporting Options

Regulatory
Tax FRF for SMEs™
Contractual Cash

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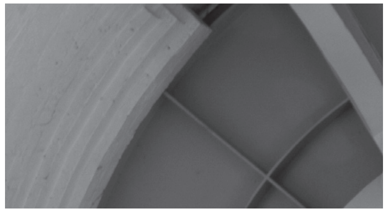

A L E R T

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2013

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Strengthening Engagement Quality
Safeguarding Financial Reporting

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SAFEGUARDING FINANCIAL REPORTING

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Notice to Readers

This alert is intended to provide accountants practicing in business and industry and practitioners in public practice with a better understanding of the AICPA's FRF for SMEs™ accounting framework, including its purpose, accounting principles, characteristics, and the compelling reasons for entities to consider adopting the framework.

The AICPA's *Financial Reporting Framework for Small- and Medium-Sized Entities* is not an authoritative publication. Use of the framework is a choice made by the management of an entity. The FRF for SMEs accounting framework is an accounting framework other than generally accepted accounting principles (GAAP) within the context of Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01). Rule 203 does not preclude an AICPA member from preparing or reporting on financial statements that have been prepared pursuant to financial reporting frameworks other than GAAP.

This document has not been approved, disapproved, or otherwise acted on by a senior committee of the AICPA.

Recognition

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Feedback

As you encounter accounting or reporting issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments or feedback you have about the alert also would be appreciated. You may e-mail any comments or feedback to A&APublications@aicpa.org or write to:

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How This Alert Helps You

This alert is intended to help you better understand the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs™ accounting framework), including its purpose, accounting principles, and characteristics, and the compelling reasons for entities to consider adopting the framework.

.01 The current accounting and financial reporting landscape abounds with complexities and requirements, many of which do not align to the needs of today's small business owners and external users of their financial statements. This alert describes a recently released financial reporting framework developed by the AICPA that is geared for simplicity and relevance. The FRF for SMEs accounting framework is now available for use by small- and medium-sized entities (SMEs) that need reliable and cost-beneficial financial statements for their own purposes as well as for external stakeholders. The FRF for SMEs accounting framework is intended for entities that are not required to prepare financial statements in accordance with generally accepted accounting principles (GAAP).

.02 This alert is designed to be used by members of an entity's financial management and practitioners to gain a better understanding of the new framework so it can be appropriately evaluated for use by its intended audience and so practitioners can appropriately advise clients regarding its potential adoption as the entity's framework of choice. Further, as business owners, financial managers, preparers, and practitioners gain an understanding of the framework, it will foster acceptance by third-party users.

.03 This alert is an important tool to help you identify key considerations in evaluating the benefits of the FRF for SMEs accounting framework and whether entities for whom the framework was developed would find it a good fit in circumstances under which GAAP financial statements are not required. This alert also helps both preparers and practitioners understand the requirements of the framework in order to have a basis for determining the form and content of the financial statements prepared in accordance with the FRF for SMEs accounting framework. Although the framework may not specify how to account for or disclose all transactions or events, it embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. You should refer to the full text of *Financial Reporting Framework for Small- and Medium-Sized Entities* for the most comprehensive source of guidance about the framework itself.

Overview—Financial Reporting Framework for Small- and Medium-Sized Entities

.04 Many privately owned small- and medium-sized entities in the United States are not currently required to prepare financial statements based on U.S. generally accepted accounting principles (U.S. GAAP). These entities, many of which are owner-managed, would benefit from a more relevant, streamlined, and cost effective financial reporting framework that is reliable, less complex, and suited for their circumstances. In a November 2012 press release, Barry C.

Melancon, CPA, CGMA, AICPA president and CEO commented, "The AICPA has heard from privately held businesses, including the CPAs and bankers serving those companies, about their long overdue need for financial reporting relief." Mr. Melancon added, "Stakeholders involved with private small- and medium-sized business entities' financial reporting have made it known that they are looking for an alternative to the current financial reporting systems outside of GAAP."

.05 The FRF for SMEs accounting framework is the result of the AICPA and the CPA profession in action, anticipating and meeting client and employer needs in a changing and complex world. The AICPA board of directors and the governing council strongly supported the development of this framework as a solution, providing another reporting option to businesses that often have limited resources but are the cornerstone of America's job growth. In short, the framework is designed to meet the needs of Main Street businesses, primarily by saving time and costs and producing financial statements that are relevant to business owners, lending institutions, and other internal and external users. Built by the profession, the framework underscores the CPAs' role as trusted business advisers for America's small business community.

Purpose and Intended Users of the Framework

.06 In June 2013, the AICPA released the *Financial Reporting Framework for Small- and Medium-Sized Entities*. It was developed by the AICPA FRF for SMEs Task Force (task force) and the staff of the AICPA and is based, in part, on Canada's Accounting Standards for Private Enterprises used under license from The Canadian Institute of Chartered Accountants (Chartered Professional Accountants of Canada). The task force was composed of CPAs in public practice and in the banking industry who have years of experience serving small- and medium-sized entities. The framework is a self-contained special purpose framework (SPF) intended for use by privately held SMEs in preparing their financial statements. The framework draws upon traditional methods of accounting blended with some accrual income tax accounting methods. Prior to its release, the framework was exposed for public comment so that broad stakeholder input could be considered and incorporated.

.07 The FRF for SMEs accounting framework was developed to address transactions that are typically encountered by private, for-profit SMEs. If the framework does not specifically address a transaction, other event, or condition, management is advised to use its judgment and apply the general principles, concepts, and criteria contained in the framework to develop accounting policies. As such, the framework is intended to be less-prescriptive and more principles-based. The framework emphasizes the use of professional judgment in applying overall principles and deemphasizes bright line rules, a dependence on interpretive guidance, and a need for extensive implementation materials.

.08 Financial statements are a structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework. The term *financial reporting framework* is defined as a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. Examples of financial reporting frameworks are U.S. GAAP, International Financial Reporting

Standards (IFRS), and special purpose frameworks (also known as other comprehensive bases of accounting [OCBOA]).

.09 The FRF for SMEs accounting framework does not define the term *small- and medium-sized entities*. It is simply not feasible to define conclusively the characteristics of a typical entity that would use and benefit from the framework. The framework is intended for owner-managers who rely on a set of financial statements to confirm their assessments of performance and to confirm what they own and owe. Owner-managers also rely on the financial statements to understand their cash flows and to present a comprehensive, yet concise, financial picture of their businesses. Often, their financial statements support applications for bank financing when the banker does not base a lending decision solely on the financial statements but also on available collateral or other evaluation mechanisms not related to the financial statements. A majority of these owner-managers have no expectations of going public.

.10 Owner-managed entities are closely held companies wherein the people who own a controlling ownership interest in the entity are substantially the same set of people who run the company, in contrast with public companies in which the ownership and management are clearly separated. Owner-managed businesses represent the majority of all businesses in the United States. For perspective on the number of potential SMEs, the segment is sizeable; some estimates put the number of SMEs in the United States at approximately 20 million.

.11 Often, owner-managed entities do not have a qualified CPA on staff. Rather, the owner-managers or bookkeepers maintain the entities' books and records. The term *owner-managed* was selected to help describe the typical entity that would benefit from using the framework. The AICPA does not intend to scope out entities that may not be owner managed from using the framework. Entities that have operational management who are not the owners may find that the framework is an ideal choice for their financial reporting needs and circumstances.

.12 Ultimately, the choice to adopt the FRF for SMEs accounting framework will be influenced by the unique circumstances of the business and the needs of its financial statement users, who may include lenders, sureties, private investors, and others. The framework is most appropriate for privately owned SMEs that do not have complex financial statements and have no intent to go public. Typically, entities that would utilize the framework have external financial statement users who have direct access to the organization's owner or manager. Management is also encouraged to collaborate with its CPA firm, or other accounting and financial reporting adviser, when evaluating any decision to adopt the framework. For those entities looking for a simplified, reliable, consistent, and cost-beneficial financial reporting option when the use of U.S. GAAP is not required, this framework could be the best choice available.

.13 The FRF for SMEs accounting framework is not intended for everyone, such as those who are required to use U.S. GAAP. Further, the framework does not address many of the issues specific to not-for-profit entities and it is not likely they would find it suitable for use. Moreover, the framework should not be used by an entity that is not a going concern and that prepares its financial statements on the liquidation basis of accounting. The going concern basis of accounting presumes that an entity will be able to realize its assets and discharge its liabilities in the ordinary course of business.

Authoritative Status and Effective Date

.14 The AICPA has no authority to require the use of the framework for any entity. Similarly, the AICPA cannot preclude an entity from preparing its financial statements under the framework.

.15 The framework will have no effective date and management can decide to use it upon release. Management should make that decision in conjunction with those who may use the entity's financial statements. The framework is not intended to be a substitute for GAAP when GAAP-based financial statements are necessary or appropriate.

Financial Reporting Frameworks Defined

.16 A financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. ET section 203, *Accounting Principles* (AICPA, *Professional Standards*), of the AICPA Code of Professional Conduct recognizes two general types of financial reporting frameworks: GAAP and financial reporting frameworks other than GAAP. In the context of ET section 203, GAAP means those accounting principles promulgated by bodies designated by AICPA Council and does not refer specifically to U.S. GAAP (although U.S. GAAP certainly meets the requirements of this first type of framework). The FRF for SMEs accounting framework is a special-purpose framework and falls within the second type of financial reporting framework—financial reporting frameworks other than GAAP. Although not defined in the Code of Professional Conduct, SPFs consist of one of the following bases of accounting:

- *Cash basis*. A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- *Tax basis*. A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- *Regulatory basis*. A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- *Contractual basis*. A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- *Other basis*. A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as OCBOA.

.17 For quite some time, many smaller businesses have determined that financial statements prepared in accordance with a SPF more appropriately suit their needs rather than GAAP. The FRF for SMEs accounting framework is a high-quality addition to the current offerings of SPFs. The scrutiny applied throughout the development of the framework, including exposing it for public comment, delivers reliability and cost efficiency.

Attributes and Structure

.18 The task force believes that the framework is criteria suitable for general use financial statements and can be used by users external to the entity. An important pillar of the framework is that its use requires the exercise of professional judgment. The key attributes of the framework are as follows:

- *Objectivity*. The framework is free from bias.
- *Measurability*. The framework permits reasonably consistent measurements.
- *Completeness*. The framework is sufficiently complete so that those relevant factors that would alter a conclusion about the financial statements are not omitted.
- *Relevance*. The framework is relevant to financial statement users.

.19 The *Financial Reporting Framework for Small- and Medium-Sized Entities* is topically organized by chapter and includes 31 chapters, plus a glossary. Chapter 1, "Financial Statement Concepts," describes certain key financial statement concepts, including estimates, materiality, recognition criteria, measurement, the qualitative characteristics of financial statements, and elements of financial statements.

.20 The four principal qualitative characteristics of financial statements are as follows:

- *Understandability*. For the information provided in financial statements to be useful, users must be able to understand it. Users are assumed to have a reasonable understanding of business and economic activities and accounting, together with a willingness to study the information with reasonable diligence.
- *Relevance*. For the information provided in financial statements to be useful, it must be relevant to the decisions made by users. Information is relevant by its nature when it can influence the users' decisions by helping them evaluate the financial impact of past, present, or future transactions and events or confirm or correct previous evaluations. Relevance is achieved through information that has predictive value or feedback value and by its timeliness.
- *Reliability*. For the information provided in financial statements to be useful, it must be reliable. Information is reliable when it is in agreement with the actual underlying transactions and events, the agreement is capable of independent verification, and the information is reasonably free from error and bias. Reliability is achieved through representational faithfulness, verifiability, and neutrality. Neutrality is affected by the use of conservatism in making judgments under conditions of uncertainty.
- *Comparability*. For users of financial statements to identify similarities and differences, the information provided by two sets of financial statements must be comparable. Comparability is a

characteristic of the relationship between two pieces of information rather than of a particular piece of information by itself. Comparability is important when comparing the financial statements of two different entities and when comparing the financial statements of the same entity over two multiple periods or at two different points in time.

.21 Elements of financial statements are the basic categories of items portrayed therein in order to meet the objective of financial statements. The seven elements of financial statements are assets, liabilities, equity, revenues, expenses, gains, and losses. Net income is the residual amount after expenses and losses are deducted from revenues and gains. Net income generally includes all transactions and events increasing or decreasing the equity of the entity, except those that result from equity contributions and distributions. Notes to financial statements, although an integral part of financial statements and useful for the purpose of clarification or further explanation of the items in financial statements, are not considered to be an element.

.22 Chapter 1 of *Financial Reporting Framework for Small- and Medium-Sized Entities* describes the concepts underlying the development and use of accounting principles in general purpose financial statements in order to guide preparers of financial statements and accounting practitioners when exercising their professional judgment about the application of the FRF for SMEs accounting framework. Chapter 1 does not establish principles for particular measurement or disclosure issues, and nothing in the chapter overrides any specific principles elsewhere in the framework.

.23 Chapter 2, "General Principles of Financial Statement Presentation and Accounting Policies," of *Financial Reporting Framework for Small- and Medium-Sized Entities* establishes the general principles of financial statement presentation:

- Fair presentation in accordance with the FRF for SMEs accounting framework, including notes to financial statements, supporting schedules, and supplementary information
- Going concern
- Comparative information
- Disclosure, including disclosure of accounting policies

.24 Chapter 3, "Transition," includes guidelines to ensure that when an entity transitions to the FRF for SMEs accounting framework, its financial statements provide a suitable starting point for accounting under the framework and contains high-quality, transparent, and comparable information over all periods presented. For more information on transition, see the "Transition to the FRF for SMEs Accounting Framework" section of this alert.

.25 Chapters 4–31 constitute the remainder of the framework, setting forth the technical accounting and reporting requirements of the framework and discussing the following topical areas:

- Accounting changes, changes in accounting estimates, and correction of errors
- Business combinations
- Commitments
- Consolidated financial statements and noncontrolling interests

- Contingencies
- Current assets and current liabilities
- Disposal of long-lived assets and discontinued operations
- Equity
- Equity, debt, and other investments
- Foreign currency translation
- Income taxes
- Intangible assets
- Interests in joint ventures
- Inventories
- Leases
- New basis (push-down) accounting
- Nonmonetary transactions
- Property, plant, and equipment
- Related party transactions
- Retirement and other postemployment benefits
- Revenue
- Risks and uncertainties
- Special accounting considerations for certain financial assets and liabilities
- Statement of cash flows
- Statement of financial position
- Statement of operations
- Subsequent events
- Subsidiaries

Key Principles and Benefits

.26 The framework is designed to be simple and sensible for business owners and preparers while providing financial statement users with the information they need. Much of the simplicity and sensibility is derived from the framework's emphasis of historical cost as its basis for measurement. The framework makes only very limited use of market value measurements (for example, in the measurement of equity and debt securities held for sale). Further, the framework's use of certain optional accounting treatments in the areas of accounting for income taxes, subsidiaries, interests in joint ventures, and defined benefit plans (except multiemployer plans), among others, result in the framework having the flexibility to allow management to tailor their financial statements to the needs of the users.

.27 Another key feature and benefit of the framework is the absence of certain topics that are not considered especially relevant to most small businesses, including the concepts of variable interest entities, comprehensive income, and extraordinary items. Moreover, the FRF for SMEs accounting framework steers away from complicated fair value measures and impairment testing of long-lived assets. These features help make the FRF for SMEs accounting framework a cost-effective approach to financial reporting.

Comparisons to Other Bases of Accounting

.28 When GAAP is neither necessary nor required, and other bases of accounting are not suitable, the framework can be an ideal option for management, owners, and other stakeholders who need financial statements that contain only relevant information and that focus on a business's cash flow and what a business owns and owes. As entities evaluate whether the framework would be a good choice for their needs, the decision should be based on which framework is the most suitable and relevant, among other considerations. As part of that evaluation, it may be helpful for stakeholders to understand how the principles and criteria included in the FRF for SMEs accounting framework compare to other bases of accounting.

.29 To assist those stakeholders, comparisons of the FRF for SMEs accounting framework to (*a*) the tax basis, (*b*) U.S. GAAP, and (*c*) the International Financial Reporting Standard for Small- and Medium-Sized Entities (IFRS for SMEs) are presented as follows. These comparisons are not all inclusive and do not list every difference between the framework and the other bases of accounting. Rather, the following comparisons are made at a high level and are intended to draw attention to differences between the FRF for SMEs accounting framework and the other bases of accounting on certain accounting and financial reporting matters.

Comparison of the FRF for SMEs Accounting Framework With Tax Basis Accounting (May 2013)

.30 The FRF for SMEs accounting framework draws upon a blend of traditional methods of accounting and accrual income tax accounting. One of its key features is that adjustments needed to reconcile tax return income with book income are reduced. The following is a comparative discussion of the FRF for SMEs accounting framework and tax basis accounting for certain topics considered significant for most users of the framework. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and the tax basis of accounting. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

Overview of Tax Basis Financial Statements

.31 The *tax basis* is defined as "a basis of accounting that the entity uses to file its income tax return for the period covered by the financial statements." It is typically based on federal income tax laws found in the Internal Revenue Code (IRC), along with related regulations, revenue rulings, and procedures. These laws and regulations generally deal with the determination of taxable income and, therefore, focus on the measurement of revenues and expenses (and in some cases, on the determination of the basis of assets and liabilities). However, income tax laws generally do not address financial statement presentation or disclosure considerations.

IRS Accounting Methods

.32 The tax basis of accounting covers a range of alternative bases, from cash to full accrual, depending on the nature of the reporting entity and, in some cases, the entity's elections. In general, the IRC allows two overall methods of accounting: the cash method and the accrual method.

- Under the cash method (used by many small businesses)

- income includes all items actually or constructively received during the year, and
- expenses are generally deducted in the year they are actually paid or the property is transferred.

- Under the accrual method
    - income is generally reported in the year earned.
    - expenses are generally deducted in the year incurred.
    - generally, the IRC requires that businesses that use inventories (they produce or purchase merchandise and sell it to produce income) use the accrual method for inventory purchases and sales.

Entities may select an accounting method based on the following rules.

C Corporations	• Generally, C corporations are required to use the accrual method of accounting. • However, the Internal Revenue Code (IRC) allows the use of the cash method if the corporation's average gross receipts are $5 million or less for the prior 3 years. • The IRC allows qualified personal service corporations to use the cash method.
S Corporations	• S corporations generally are eligible to use either the cash or accrual method. • However, S corporations that allocate more than 35% of their losses to shareholders who do not actively participate in the management of the business cannot use the cash method.
Partnerships	• Partnerships are generally eligible to use either cash or accrual. • However, limited partnerships generally cannot use the cash method if they allocate more than 35% of their tax losses to limited partners. • If general or limited partnerships have C corporation partners, they cannot use the cash method if the partnerships have average gross receipts of more than $5 million for the three preceding tax years.
Sole Proprietorships	• Generally, sole proprietorships are eligible to use either cash or accrual. • A sole proprietor may use the accrual method for the business and the cash method for nonbusiness income and deductions.

Key Differences Between the FRF for SMEs Accounting Framework and the Tax Basis of Accounting

.33 Although the FRF for SMEs accounting framework largely parallels the accrual method under the tax basis of accounting, the FRF for SMEs reporting option provides a more comprehensive and consistent financial reporting and accounting basis than the tax basis. This leads to a more complete presentation of the entity's financial position, results of operations, and cash flows, as well as more informative disclosures.

Revenue and Expense Recognition

.34 Generally, revenue and expense recognition does not differ between the FRF for SMEs accounting framework and the accrual method for income tax reporting purposes.

Revenue	Under the tax basis, income is generally reported in the year earned. • Entities using the tax basis generally include an amount as gross income for the tax year in which — all events that fix the entity's right to receive the amount have occurred, and — the entity can determine the amount with reasonable accuracy. Under this rule, an amount is included in gross income on the earliest of the following dates: • When payment is received • When the income amount is due to the entity • When the income is earned
Expenses	Expenses are generally deducted or capitalized when all of the following conditions are met: • All events necessary to establish the fact of liability or deduction have occurred. • The amount of the liability or deduction is determinable with reasonable accuracy. • Economic performance has occurred. — Generally, economic performance occurs when property or services are provided to (or by) another party, or when the property is used.

Special Revenue Situations

.35 As stated previously, generally, revenue recognition does not differ between the FRF for SMEs accounting framework and the accrual method for income tax reporting purposes. However, special rules may apply to the following:

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Installment Sales	• Revenue is ordinarily recognized at the time a sale is made, even if the sales price will be collected in installments.	• Income from an installment sale is recognized when it is fixed and determinable and all events have occurred. • Deductions are permitted later if the sale becomes uncollectible.
Sales Returns	• Recognition of probable returns in the period the sale is recognized.	• No allowance for returns is permitted—returns cannot be recorded until they occur.
Advance Payments	• Advance payments are generally recorded as deferred revenue and recognized when earned.	• Advance payments for services to be performed in a later tax year are generally recognized as income in the year the payment is received. • However, if the services are to be performed by the end of the next tax year, the entity can elect to postpone recognizing the advance payment until the next tax year.
Long-Term Contracts	• Performance should be determined using one of the following methods: — Percentage-of-completion method — Completed-contract method • Used when the entity cannot reasonably estimate the extent of progress toward completion • May also be used if the following conditions are met: — The completed-contract method is used for income tax reporting purposes.	• Generally, entities must report earnings from long-term contracts for tax purposes using the percentage-of-completion method. • However, entities with average gross receipts of $10 million or less for the 3 taxable years preceding the contract year and that perform only real property contracts that will be completed within 2 years or manufacturing contracts that will be completed within 1 year may use the completed-contract method.

(continued)

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
	— The financial position and results of operations of the entity would not vary materially from those resulting from use of the percentage-of-completion method (for example, in circumstances in which an entity has primarily short-term contracts).	
Rental Income and Expense	• Lessees and lessors generally recognize rent under noncancellable operating leases on a straight-line method over the period the lessee controls the use of the leased property.	• Accrual method lessors usually recognize rental income under operating leases when earned. • Accrual method lessees generally recognize rent expense under operating leases when payments are due.

Statement of Financial Position Measurement and Presentation Issues

.36

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Receivables	• Allows entities to provide an allowance for receivables for which collection is doubtful.	• Must use the specific charge-off method to deduct bad debt losses related to trade notes and accounts receivable. Receivables are not charged to expense until all collection efforts have been exhausted and they are deemed worthless.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Inventories	• Inventory is measured at the lower of cost or net realizable value. • Cost is determined by any of the conventional cost flow assumptions. • Charging all overhead costs to expense is not permitted. • Abnormal amounts of production costs, wasted materials, and labor are to be charged to expense in the year they are incurred. • Overhead costs are allocated based on normal production capacity. This might create differences between inventory calculated under the framework and under tax laws. • Inventory losses are essentially recorded when they are probable and estimable, whether they result from obsolescence, damage, or declining prices.	• Inventory is generally valued using the cost method, lower of cost or market method, or retail method. • Cost is determined by any of the conventional cost flow assumptions. • Charging all overhead costs to expense is not permitted. • Inventory losses are generally not recognized until the inventory is actually offered for sale at lower prices or until the inventory is actually sold or discarded.
Investments	• Equity and debt instruments held for sale are accounted for at market value, which results in unrealized gains and losses being recognized in some cases. • The equity method is used to account for investments when the investor can exercise significant influence over the investee. Generally, significant influence exists when the ownership interest is 20% or more.	• In general, investments in debt and equity securities are carried at cost for income tax reporting purposes. Accordingly, gains and losses under the income tax basis generally are recognized only when realized. • For tax purposes, the equity method of accounting does not exist. Instead, dividend income is included in income. • A pro rata share of the investee income or loss is not recorded by the investor.

(continued)

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Prepaid Expenses	• Recorded as an asset and amortized to expense.	• Expenses paid in advance are deductible only in the year to which the expense applies, unless the expense qualifies for the "12-month rule." • Under the 12-month rule, the entity is not required to capitalize amounts paid to create certain rights or benefits that do not extend beyond the earlier of the following: — 12 months after the right or benefit begins — The end of the tax year after the tax year in which payment is made
Property and Equipment	• Requires depreciation to be recognized in a rational and systematic manner over the useful life of the asset. Depreciation expense is calculated on the cost less any expected *residual value*. • Assets contributed by an owner are valued at market value. • Does not recognize an expense similar to the IRC Section 179 deduction for costs incurred to acquire certain property and equipment during the year within specified limitations.	• Most property and equipment is depreciated under the Modified Accelerated Cost Recovery System (MACRS), often resulting in more rapid depreciation over shorter lives than would be used under the FRF for SMEs accounting framework. • Internal Revenue Code (IRC) Section 179 permits taxpayers to deduct the cost incurred to acquire certain property and equipment during the year within specified limitations. • Assets contributed by an owner may be valued at the owner's tax basis.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
		• Tax laws pertaining to capital leases are less explicit than under the FRF for SMEs accounting framework. Generally, for tax purposes, an equipment lease is not considered to be a capital lease unless it contains a bargain-purchase option.
Intangible Assets	• Goodwill is amortized over a 15-year period. • A recognized intangible asset is amortized over the best estimate of its useful life.	• Intangible assets (including goodwill) acquired after August 10, 1993 (or July 25, 1991, if elected), are referred to as IRC Section 197 intangibles and may be amortized over a 15-year life beginning with the month the assets were acquired.
Consolidation	• Consolidation is based on a threshold of more than 50% ownership. • The framework provides more explicit guidance on accounting for a business combination, as well as subsequent consolidation.	• The threshold for consolidation under the IRC is 80% ownership.

Comparison of the FRF for SMEs Accounting Framework With U.S. GAAP—Major Areas (May 2013)

.37 The following table presents a high-level comparison of the FRF for SMEs accounting framework with U.S. GAAP for certain key topics. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and U.S. GAAP. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

Topic	*FRF for SMEs Accounting Framework*	*U.S. GAAP*
Fair Value	• Uses the term *market value*. It is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act." • Market value measurement used only in very limited circumstances, such as business combinations, certain nonmonetary transactions, and marketable equity and debt securities that are held for sale.	• *Fair value* is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." • Provides an overall framework to measuring fair value (for example, fair value hierarchy, valuation techniques). • Standardized disclosure requirements for fair value measurements. • Nonpublic entities are exempt from certain fair value disclosures.
Going Concern	• Requires management assessment of whether the going concern basis of accounting is appropriate. • When management becomes aware of material uncertainties relating to events or conditions and concludes that a known event or condition is probable of having a severe impact on the entity's ability to realize its assets and discharges its liabilities in the ordinary course of business, the entity should disclose those uncertainties along with its plans for dealing with the adverse effects of the conditions and events.	• No requirement for management assessment of whether the going concern basis of accounting is appropriate. • No requirement for specific disclosures.
Impairment	• No assessment of impairments for long-lived assets.	• Long-lived assets are tested for impairment upon a triggering event.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
	• A depreciated or amortized cost approach is followed. Assets no longer used are written off.	• Goodwill and indefinite-lived intangible assets are subject to an impairment test annually. An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted (Step 0).[1]
Comprehensive Income	• No concept of comprehensive income or items of other comprehensive income (OCI).	• Certain items are classified as OCI and displayed as such.
Industry-Specific Guidance	• Framework does not contain industry-specific guidance.	• Extensive industry-specific guidance. • The Financial Accounting Standards Board is in the process of finalizing a broad principles-based revenue recognition model that will replace industry-specific revenue guidance.
Consolidation/ Subsidiaries	• Policy choice to either consolidate subsidiaries or account for subsidiaries using the equity method. • *Subsidiary* defined as an entity in which another entity owns more than 50% of the outstanding residual equity interests. • No concept of variable interest entities (VIEs).	• Consolidation is required for reporting entity with controlling financial interest in another entity. • VIE model is used when controlling financial interest is achieved through arrangements that do not involve voting interests.[2]
Income Taxes	• Policy choice to account for income taxes using either the taxes payable method or the deferred income taxes method. • No evaluation or accrual of uncertain tax positions.	• Income taxes accounted for using a deferred income tax method. • Uncertain income tax positions must be evaluated and accrual made if certain conditions are met.

(continued)

[1] The Private Company Council (PCC) tentatively decided to provide private companies an alternative to (*a*) amortize goodwill, (*b*) only test goodwill for impairment upon a triggering event, and (*c*) to further simplify the goodwill impairment test.

[2] The PCC currently has an ongoing project to consider the application of variable interest entity guidance to common control leasing arrangements.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Leases	• Traditional accounting approach blended with some accrual income tax accounting methods. • Lessee classifies leases as either operating or capital leases. • Lessor accounts for leases as sales type, direct financing, or operating.	• Lessee classifies leases as either operating or capital leases. • Lessor accounts for leases as sales type, direct financing, or operating.[3]
Push-Down Accounting	• New basis (push-down) accounting guidance provided. • Specific guidance provided on comprehensive revaluation of assets and liabilities under certain conditions.	• No requirement to apply push-down accounting.
Intangible Assets	• All intangible assets are considered to have a finite useful life and are amortized over their estimated useful lives. • In accounting for expenditures on internally-generated intangible assets during the development phase, management should make an accounting policy choice to either expense such expenditures as incurred or capitalize such expenditures as an intangible asset, provided the criteria are met.	• A recognized intangible asset is amortized over its useful life unless that life is determined to be indefinite. • Intangible assets subject to amortization are tested for impairment upon a triggering event. • Indefinite-lived intangible assets are subject to an impairment test annually. An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted.

[3] The Financial Accounting Standards Board (FASB) has an ongoing project to revamp its current lease accounting model and adopt a right-of-use (ROU) model. The lessee would recognize a ROU asset and liability for all lease contracts (other than short-term leases). The lessor would account for a lease under either the type A approach (receivable and residual) or the type B approach (operating lease) on the basis of the nature of the underlying asset and the terms and conditions of the lease.

Topic	FRF for SMEs Accounting Framework	Tax Basis
Goodwill	• Amortized over the same period as that used for federal income tax purposes or 15 years. • No impairment testing.	• No amortization. • Tested for impairment at least annually. • An impairment test is also required upon a triggering event. Optional qualitative assessment is permitted (Step 0).[4]
Revenue	• Broad, principle-based guidance on revenue recognition. • Revenue should be recognized when performance is achieved and ultimate collection is reasonably assured. • *For goods*. Performance is achieved when the entity transfers the risks and rewards associated with the goods to a customer. • *For services*. Performance should be determined using either the percentage-of-completion method or the completed-contract method. Performance should be regarded as having been achieved when reasonable assurance exists regarding the measurement of the consideration that will be derived from rendering the service or performing the long-term contract.	• Revenue is realized or realizable when all of the following criteria are met:[5] — Persuasive evidence of an arrangement exists. — Delivery has occurred or services have been rendered. — The seller's price to the buyer is fixed or determinable. — Collectability is reasonable assured. Construction and production contracts are accounted for using the percentage-of-completion method or completed-contract method. • Industry-specific guidance.

(continued)

[4] See footnote 1.

[5] FASB is in the process finalizing a new revenue recognition model. The core principle of the new model is that an entity should recognize revenue when promised goods or services are transferred to customers. The amount of revenue recognized reflects the consideration that is expected in exchange for those goods or services. The new revenue guidance will be effective for nonpublic entities with an annual reporting period beginning after December 15, 2017.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Investments/ Financial Assets and Liabilities	• Historical cost approach. • Market value measurement required only for investments being held for sale. • Changes in market value included in net income.	• Classification required based on management intent and ability. • Securities classified as "available for sale" or "trading" measured at fair value. • Debt securities classified as "held-to-maturity" measured at amortized cost. • Accounting for changes in fair value depends upon classification.
Derivatives	• Disclosure approach. • Recognition at settlement (cash basis). • No hedge accounting.	• All derivatives recognized as either assets or liabilities.[6] • Measured at fair value. • Accounting for changes in fair value depends on the use of the derivative. • Hedge accounting permitted.
Stock-Based Compensation	• Disclosure only.	• Stock-based compensation is classified as liability or equity. • Accounting for stock-based compensation depends upon classification. • Measurement of stock-based compensation is fair-value based. • Nonpublic entities permitted to measure stock-based compensation under calculated-value method. When it is not possible to reasonably estimate fair value or calculated value, intrinsic value is permitted.

[6] The PCC tentatively decided to provide private companies alternatives to account for interest rate swaps entered only for the purpose of economically converting its variable-rate borrowing to a fixed-rate borrowing if certain criteria are met. The PCC also tentatively decided to provide private companies a simplified shortcut method to make it easier to qualify for hedge accounting on such swaps.

Topic	*FRF for SMEs Accounting Framework*	*Tax Basis*
Defined Benefit Plans	• Policy choice to account for plans using either a current contribution payable method or one of the accrued benefit obligation methods.	• Plans accounted for using a projected benefit obligation model.
Business Combinations	• As of the acquisition date, the acquirer should recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Identifiable assets acquired and liabilities assumed are measured at their acquisition-date market values. Certain exceptions exist. • An entity should make an accounting policy choice to account for an intangible asset acquired in a business combination either by separately recognizing the intangible asset as an identifiable asset or by not separately recognizing the intangible asset as an identifiable asset and subsuming into goodwill the value of the intangible asset.	• As of the acquisition date, the acquirer should recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. Identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. Certain exceptions exist.[7]
Inventories	• Valued at lower of cost or net realizable value.	• Valued at lower of cost or market, with market generally considered to be replacement cost; however, market is not permitted to exceed net realizable value or be less than net realizable value less a normal profit margin.

[7] The PCC tentatively decided to provide private companies an alternative to only recognize intangible assets arising from noncancellable contractual terms or those arising from other legal rights. This would likely result in fewer intangible assets being separately recognized.

Comparison of the FRF for SMEs Accounting Framework With IFRS for SMEs—Major Areas (May 2013)

.38 In general, the FRF for SMEs reporting option is similar in many ways to IFRS for SMEs. Both are intended to be simplified, relevant, and cost-effective financial reporting frameworks for SMEs. In addition, both contain targeted financial statement disclosures and contain less prescriptive guidance. However, the IFRS for SMEs is GAAP whereas the FRF for SMEs reporting option is a non-GAAP special purpose framework (an other comprehensive basis of accounting [OCBOA]). Also, the parameters defining what kinds of entities are intended to utilize the framework and IFRS for SMEs are different, with IFRS for SMEs having a more prescribed scope. The following table presents a high-level comparison of the FRF for SMEs accounting framework with IFRS for SMEs for certain key topics. This presentation does not describe all of the differences between the FRF for SMEs accounting framework and IFRS for SMEs. Rather, the presentation highlights areas that AICPA staff believes would be of particular interest to stakeholders.

Topic	***FRF for SMEs Accounting Framework***	***IFRS for SMEs***
Comparative Financial Statements	• Comparative financial statements are not required.	• Requires comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements. • An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.
Comprehensive Income	• No concept of comprehensive income or items of other comprehensive income.	• Provides an accounting policy choice between presenting total comprehensive income in a single statement or in two separate statements. • Certain items are classified as other comprehensive income and displayed as such.

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Fair Value	• Uses the term *market value*. It is defined as "the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act." • Market value measurement used only in very limited circumstances, such as business combinations, certain nonmonetary transactions, and marketable equity and debt securities held-for-sale.	• Use the term *fair value*. It is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. • Wider use of fair value measurements compared to the FRF for SMEs accounting framework.
Inventories	• Last in, first out (LIFO) is permitted.	• LIFO is not permitted. • Inventory is assessed at the end of each reporting period for impairment or for recovery of previously recognized impairment.
Subsidiaries	• *Subsidiary* defined as an entity in which another entity owns more than 50% of the outstanding residual equity interests. • Policy choice to either consolidate subsidiaries or account for subsidiaries using the equity method. • No concept of special purpose entities (SPEs) or variable interest entities.	• *Subsidiary* defined as an entity that is controlled by the parent. • Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. • If an entity has created a SPE to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity.

(continued)

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Investments/ Financial Assets and Liabilities	• Historical cost approach for investments and financial assets and liabilities. • Market value measurement required only for investments being held for sale, with changes in market value included in net income. • Investees over which the investor has significant influence are accounted for under the equity method.	• There are two classification categories for financial instruments: amortized cost and fair value through earnings. • Basic financial instruments are measured at amortized cost except for investments in nonconvertible and nonputtable preference shares and nonputtable ordinary shares that are publicly traded or whose fair value can be measured reliably. • All instruments other than basic debt instruments (including instruments with embedded derivatives) are measured at fair value through earnings. • Investments in associates (*associates* are entities in which the investor has the ability to exercise significant influence) are accounted for using one of the following methods: the cost method (if there is no published price quotation), equity method, or fair-value-through-earnings method.
Derivatives	• Disclosure approach. • Recognition at settlement (cash basis). • No hedge accounting.	• Derivatives are recognized and measured at fair value through earnings. • Hedge accounting prescribed.
Stock-Based Compensation	• Disclosure only.	• Compensation expense is recognized. • Specific accounting depends on terms and type of instrument.

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Leases	• The criteria for determining whether a lease is a capital lease to a lessee generally are similar to IFRS for SMEs. Unlike IFRS for SMEs, however, the FRF for SMEs accounting framework provides specific quantitative thresholds for determining certain criteria. • Under the FRF for SMEs accounting framework, if land is the sole item of property leased, the lessee accounts for the lease as a capital lease only if the lease transfers ownership of the property at the end of the lease term. • From the point of view of a lessor, some additional criteria must be met to classify the lease as a capital lease. • Under the FRF for SMEs accounting framework, lessors' capital leases are categorized as direct financing leases or sales-types leases (both similar to the finance lease category in IFRS for SMEs).	• See the FRF for SMEs Accounting Framework column.
Goodwill	• Amortized over the same period as that used for federal income tax purposes or 15 years. • No impairment testing.	• Goodwill is amortized over its useful life. If an entity cannot reliably estimate its useful life, the life is presumed to be 10 years. • Impairment testing is required only when there is an indicator of impairment.

(continued)

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Intangible Assets	• All intangible assets are considered to have a finite useful life and are amortized over their estimated useful lives. • In accounting for expenditures on internally-generated intangible assets during the development phase, management should make an accounting policy choice to either expense such expenditures as incurred or capitalize such expenditures as an intangible asset, provided the criteria are met.	• All intangible assets (including goodwill) are finite-lived and are amortized over their useful lives. If an entity cannot reliably estimate the useful life of an intangible asset, the life is presumed to be 10 years. • Expenditures on internally developed intangibles, including research and development costs, are expensed as incurred, unless they are part of the cost of another asset that meets the recognition criteria in IFRS for SMEs.
Statement of Cash Flows	• Cash inflows from interest and dividends received should be classified as cash flows from operating activities. • Cash outflows related to interest paid should be classified as an operating activity, unless capitalized. • Cash outflows related to dividends paid should be classified as cash flows used in financing activities. • Cash outflows from dividends paid by subsidiaries to noncontrolling interests should be presented separately as cash flows used in financing activities.	• An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. • Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows, respectively, because they are costs of obtaining financial resources or returns on investments. • An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. • Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Debt Covenant Violation	• Debt covenant violations may be cured after the balance sheet date, eliminating the need to reclassify the debt.	• Curing a debt covenant violation after the balance sheet date may not eliminate the need to reclassify the debt.
Investment Property	• No specific definition of investment property. Investments in land and buildings are accounted for as property, plant, and equipment.	• Separate accounting guidance for investment property. • Investment property is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of business.
Component Depreciation	• No requirement for separate components of an asset (nor is there a prohibition against doing so). • Composite depreciation method may be used.	• If the major components of an item of property, plant, and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life.

(continued)

Topic	***FRF for SMEs Accounting Framework***	***IFRS for SMEs***
Joint Ventures	• A venturer should make an accounting policy choice to account for its interests in joint ventures using one of the following methods: — Equity — Proportionate consolidation • Only applicable to unincorporated entities for which it is an established industry practice	• Investments in jointly controlled entities may be accounted for using one of the following methods: — Cost (if there is no published price quotation) — Equity — Fair-value-through-earnings
Impairment of Long-Lived Assets	• No assessment of impairments for long-lived assets. • A depreciated or amortized cost approach is followed. Assets no longer used are written off.	• Impairment testing is required only when there is an indicator of impairment.
Contingencies	• A contingency is recognized when it is probable that a future event will confirm that the value of an asset has diminished or a liability incurred at the date of the financial statements and the amount of the loss can be reasonably estimable. • *Probable* is defined as likely to occur, a threshold higher than the "more likely than not" threshold used in IFRS for SMEs.	• A contingency is recognized when it is more likely than not that the entity will be required to transfer economic benefits in settlement and the amount of the obligation can be estimated reliably.
Income Taxes	• Policy choice to account for income taxes using either the taxes payable method or the deferred income taxes method. • No evaluation or accrual of uncertain tax positions.	• Income taxes accounted for using a deferred income tax method. • Uncertain income tax positions must be evaluated and accrual made if certain conditions are met.

Topic	*FRF for SMEs Accounting Framework*	*IFRS for SMEs*
Borrowing Costs	• An entity can choose to capitalize interest costs related to an item of property, plant, and equipment that is acquired, constructed, or developed over time. • When a financial liability is issued or assumed in an arm's length transaction, an entity should measure it at its exchange amount adjusted by financing fees and transaction costs that are directly attributable to its origination, acquisition, issuance, or assumption. • An entity can choose to capitalize interest costs related to inventories that require a substantial period of time to get them ready for their intended use or sale.	• Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. An entity should recognize all borrowing costs as an expense in net income in the period in which they are incurred.
Long-Lived Assets Held for Sale	• A long-lived asset to be sold should be classified as held for sale and presented separately in the entity's statement of financial position. The assets and liabilities of a disposal group classified as held for sale should be presented separately in the asset and liability sections, respectively, of the statement of financial position. • A long-lived asset should not be amortized while it is classified as held for sale.	• There is no "held for sale" classification for nonfinancial assets or groups of assets and liabilities and related measurement provisions.

Transition to the FRF for SMEs Accounting Framework

.39 Chapter 3 of *Financial Reporting Framework for Small- and Medium-Sized Entities* provides guidance for entities adopting the framework. Management should use the same accounting policies in its opening statement of financial position and throughout all periods presented in its first financial statements prepared using the framework. Those accounting policies should comply with the accounting policies effective at the end of the year the entity adopts the framework, unless otherwise specified.

.40 The accounting policies that management uses in its opening statement of financial position prepared in accordance with the framework may differ from those that it used for the same date under its previous accounting policies. For example, an entity may have previously reported other comprehensive income, whereas there is no such concept in the framework. Adjustments related to such situations should be recognized directly in equity at the date of transition to the FRF for SMEs accounting framework.

.41 Management may elect to use certain exemptions to the principle that an entity's opening statement of financial position should comply with the framework. Available exemptions are related to the following:

a. Business combinations

b. Financial assets and liabilities

c. Asset retirement obligations

In addition, principles in certain chapters of the framework are prohibited from being applied retrospectively to the opening statement of financial position.

.42 Interpretation No. 5, "Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP," under Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .06), states that financial statements or reports prepared in accordance with a framework other than GAAP should make clear the financial reporting framework used.

.43 In the year of adoption of the FRF for SMEs accounting framework, if prior period financial statements have been restated and presented, an entity should disclose the amount of each charge or credit to equity at the date of transition to the framework resulting from the adoption of these principles and the reason therefor. If the date of transition is earlier than the current period so that prior period financial statements can be presented, those prior year financial statements need to be restated to conform to the framework. At the date of transition, when an entity elects to use one or more of the exemptions previously described, it should disclose the exemptions used.

.44 When initial application of the FRF for SMEs accounting framework or a required change in accounting policy has an effect on the current period or any prior period, or would have such an effect except that it is impracticable to determine the amount of the adjustment, an entity should disclose

a. when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

b. the nature of the change in accounting policy;

c. when applicable, a description of the transitional provisions;

d. for the current period, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

e. the amount of the adjustment relating to periods before those presented to the extent practicable; and

f. if retrospective application required by paragraph 9.07*a*–*b* is impracticable for a particular prior period or for periods before those presented, the circumstances that led to the existence of that condition and a description of how, and from when, the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures, unless comparative financial statements are presented.

Maintenance and Updates

.45 Appreciating the limited accounting resources that typical entities utilizing the framework have and the nature of their financial reporting, the FRF for SMEs accounting framework is intended to be a stable platform that does not undergo frequent amending or updating. At the same time, the framework is intended to be responsive to the financial reporting needs of SMEs and therefore will be modified in response to significant developments in small business accounting and financial reporting. As such, AICPA staff intends to monitor and assess input related to the implementation of the framework after its initial release and propose modifications to address any implementation issues. Afterwards, AICPA staff intends to review and propose amendments to the framework approximately every three or four years. Amendments will be primarily based on input from stakeholders and developments in accounting and financial reporting.

Users of the Financial Statements

.46 The FRF for SMEs accounting framework is designed specifically to suit the needs of SMEs and their stakeholders without needless complexity and cost. The framework comprises traditional accounting and accrual income tax accounting principles, and only financial reporting topics that are relevant and have meaning to most SMEs and their financial statement users are included. For example, there is no concept of variable interest entities in the framework. The framework assists small business owner-managers and other stakeholders in focusing on the performance of the company and its assets, liabilities, and cash flows.

.47 When an entity is deciding to utilize the framework in the preparation of its financial statements, management would typically engage its CPA firm and external financial statement users, such as its banker, in the decision. The framework is intended to be used by entities whose lenders base their decisions principally on reliable operations and cash flows. It would appeal to such lenders because it is a reliable financial framework that has been developed by CPA professionals who have a tremendous knowledge of accounting principles and who have served small- and medium-sized businesses their entire careers. This framework allows for the preparation of financial statements that clearly and concisely report what a business owns, what it owes, and its cash flow. Users can clearly understand key measures of a business and its credit worthiness. Additionally, disclosure requirements are targeted, providing lenders and other users of financial statements with only the relevant information they need by recognizing that those users can obtain additional information from management if they desire.

Practitioners

.48 CPA practitioners performing audit, review, or compilation engagements on financial statements prepared under the FRF for SMEs accounting framework should follow the same standards used when reporting on other special purpose framework financial statements. The AICPA has developed audit, review, and compilation report examples to assist CPAs in reporting on financial statements prepared under the new framework. When issuing a report on financial statements prepared in accordance with the framework, the following requirements should be complied with, depending on the nature of the service:

- *Audit of financial statements*. This requirement is discussed in AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*).
- *Compilation of financial statements*. This requirement is discussed in AR section 80, *Compilation of Financial Statements* (AICPA, *Professional Standards*).
- *Review of financial statements*. This requirement is discussed in AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*).

The reporting examples included in this section are for illustrative purposes only and are nonauthoritative. CPAs should refer directly to the applicable authoritative pronouncements for reporting requirements.

.49 As trusted business advisers to their clients, CPAs are uniquely positioned to build awareness of the new framework, educate clients on the benefits of the framework, and advise clients on the adoption of the framework.

Auditors

.50 Generally accepted auditing standards have certain requirements specific to special purpose frameworks. Among other requirements, paragraph .11 of AU-C section 800 states that

> in an audit of special purpose financial statements, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including
>
> *a.* a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.
>
> *b.* informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

c. a description of any significant interpretations of the contract on which the special purpose financial statements are based, in the case of special purpose financial statements prepared in accordance with a contractual basis of accounting.

d. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation.

The AICPA task force and staff that developed the framework believe that the disclosure requirements contained in the framework will meet the similar informative disclosures requirement of AU-C section 800.

Illustrative Auditor's Report: Single Year Prepared in Accordance With the FRF for SMEs Accounting Framework

.51

Independent Auditor's Report

To the Stockholders

ABC, Inc.

We have audited the accompanying financial statements of ABC, Inc., which comprise the statement of financial position as of December 31, 2013, and the related statements of operations and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities* issued by the American Institute of Certified Public Accountants described in Note 1; this includes determining that the *Financial Reporting Framework for Small- and Medium-Sized Entities* is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC, Inc., as of December 31, 2013, and the results of its operations and its cash flows for the year then ended in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities* described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities*, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

Accountants Performing Reviews and Compilations

.52 Statements on Standards for Accounting and Review Services contain limited, principles-based guidance on special purpose frameworks. In accordance with AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements* (AICPA, *Professional Standards*), the requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

Illustrative Accountant's Review Report: Single Year Prepared in Accordance With the FRF for SMEs Accounting Framework

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Independent Accountant's Review Report

Board of Directors

XYZ Company

We have reviewed the accompanying statements of financial position of XYZ Company, as of December 31, 2013, and the related statements of operations and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of financial statements in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities* issued by the American Institute of Certified Public Accountants and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the *Financial Reporting Framework for Small- and Medium-Sized Entities*, described in Note 1.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Illustrative Accountant's Compilation Report: Single Year Prepared in Accordance With the FRF for SMEs Accounting Framework

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Accountant's Compilation Report

Board of Directors

XYZ Company

We have compiled the accompanying statements of financial position of XYZ Company, as of December 31, 2013, and the related statements of operations and cash flows for the year then ended. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities*, issued by the American Institute of Certified Public Accountants.

Management is responsible for the preparation and fair presentation of financial statements in accordance with the *Financial Reporting Framework for Small- and Medium-Sized Entities* and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

The FRF for SMEs Accounting Framework Contrasted With U.S. GAAP for Private Companies

.55 In May 2012, the Financial Accounting Foundation's (FAF's) Board of Trustees approved the establishment of the Private Company Council (PCC), a new body to improve the process of setting accounting standards for private companies. The PCC and FASB, working jointly, will mutually agree on a set of criteria to decide whether and when exceptions or modifications to U.S. GAAP are warranted for private companies. Based on those criteria, the PCC will review and propose exceptions or modifications to U.S. GAAP to address the needs of users of private company financial statements. The PCC also serves as the primary advisory body to FASB on the appropriate treatment for private companies for items under active consideration on FASB's technical agenda.

.56 The AICPA and FAF are both committed to the private-company financial reporting constituency; however, the objectives of the PCC and the AICPA's initiative to develop the framework are different. FAF's PCC focuses on modifications to U.S. GAAP for private companies. The framework is a concise, highly relevant non-GAAP special purpose framework (formerly known as OCBOA) for owners and managers of small- and mid-sized companies and their external stakeholders when U.S. GAAP financial statements are not required or necessary.

Resource Central

Discover these additional tools available to CPAs and accountants in business and industry to support an entity's financial reporting under the framework and practitioners who advise them.

.57 The following sections identify various resources that you may find beneficial in gaining an in-depth understanding of the accounting framework.

Obtain *Financial Reporting Framework for Small- and Medium-Sized Entities*

.58 The AICPA's *Financial Reporting Framework for Small- and Medium-Sized Entities* is available at no cost in PDF format on the AICPA's online Financial Reporting Center at www.aicpa.org/FRF-SMEs.

.59 Along with the framework, the AICPA has developed *Financial Reporting Framework for Small- and Medium-Sized Entities With Implementation Resources* to give users a more complete resource for adopting and using the framework. In addition to the framework, it includes illustrative financial statements, a presentation and disclosure checklist, certain illustrative application examples, and sample audit, compilation, and review reports. Available formats include print, e-book, and online download through the AICPA's Online Professional Library, all of which are available for purchase on the AICPA store at www.cpa2biz.com.

Publications

.60 In addition to this alert, the AICPA develops numerous other professional publications for practitioners and financial management professionals in the areas of audit, financial reporting, internal controls, financial management, tax, firm marketing, and other areas of interest. You'll find a publication that fits your needs within the AICPA's industry-leading library at www.cpa2biz.com/AST/AICPA_CPA2BIZ_Browse/Store/Publications.jsp.

Toolkits and Other Resources

.61 In connection with the release of the accounting framework, the AICPA has prepared a comprehensive package of resources and toolkits for firms (internal use and client facing), small business professionals, and financial statement users. These toolkits and other resources are available at www.aicpa.org/FRF-SMEs.

Industry Websites

.62 The following table includes useful websites that may provide valuable information to accountants.

Website Name	***Content***	***Website***
AICPA Financial Reporting Center	Offers resources for the entire financial reporting process, including what practitioners need to know about audit, review, and compilation engagements	www.aicpa.org/FRC
Chartered Global Management Accountant (CGMA), a joint venture between the AICPA and CIMA for management accountants	Offers resources to promote the science of management accounting on the global stage	www.cgma.org/

AICPA's Online Professional Library: Accounting and Auditing Literature

.63 The AICPA has created your core accounting and auditing library online. The AICPA Online Professional Library is now customizable to suit your preferences or your firm's needs. You can also sign up for access to the entire library. Get access—anytime, anywhere—to the Financial Accounting Standards Board *Accounting Standards Codification*®; the AICPA's latest *Professional Standards*, *Technical Practice Aids*, Audit and Accounting Guides, Audit Risk Alerts, *Accounting Trends & Techniques*; and more. To subscribe to this essential online service for accounting professionals, visit the AICPA store at www.cpa2biz.com.

Continuing Professional Education

.64 For CPAs interested in learning more about the FRF for SMEs accounting framework and also earning CPE credit, the AICPA has developed the course *Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs)*, available in July 2013 as a group study version (product no. FRFS) and available in September 2013 as a self-study version (product no. 745140).

.65 The AICPA offers a number of other CPE courses that are valuable to CPAs working in public practice and in business and industry. CPExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, CPExpress offers hundreds of hours of learning in a wide variety of topics. Subscriptions are available at www.cpa2biz.com/CPExpress (product no. BYT-XX).

.66 To register for individual courses or to learn more, visit the AICPA store at www.cpa2biz.com.

.67 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high-quality CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available for viewing. For additional details on available webcasts, please visit the AICPA store at www.cpa2biz.com/AST/AICPA_CPA2BIZ_Browse/Store/Webcasts.jsp.

Member Service Center

.68 To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Operations Center at 888.777.7077.

Hotlines

Accounting and Auditing Technical Hotline

.69 Do you have a complex technical question about U.S. GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. ET on weekdays. You can reach the Technical Hotline at 877.242.7212 or online at www.aicpa.org/Research/TechnicalHotline. Members can also e-mail questions to aahotline@aicpa.org. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

Ethics Hotline

.70 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at 888.777.7077 or by e-mail at ethics@aicpa.org.

Conferences

.71 The AICPA offers a number of conferences for practitioners in business and industry that include the most recent developments affecting the profession. Among others, two such conferences include the 2013 Practitioners Symposium and Tech+ Conference, held June 10–12, 2013, in Las Vegas, NV, and the AICPA National Advanced Accounting and Auditing Technical Symposium (NAAATS), held July 11–12, 2013, in Nashville, TN.

.72 For further information about AICPA conferences or to register, call 888.777.7077 or visit the AICPA store at www.cpa2biz.com.

Services for AICPA Members in Business, Industry, and Government

.73 The AICPA provides a number of centers and services directed at its members in business and industry, including the Business, Industry, and Government interest area; the Audit Committee Effectiveness Center; and the Audit Committee Matching System. These centers and services can be accessed by visiting www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Pages/BIGHome.aspx.

.74 In addition, the AICPA recently created the Financial Reporting Center to help CPAs meet the challenges of providing high-quality financial reporting. This center provides financial reporting information for topics important to specific industries while keeping you informed of changes to accounting standards. Visit www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/Pages/AccountingFinancialReporting.aspx for more information.

Share Your Thoughts

.75 Additional opportunities are available online to share your thoughts about the framework:

- *AICPA Insights* blog post "New Reporting Framework Will Eliminate 'Noise' for Bankers, Other Financial Statement Users": http://blog.aicpa.org/2013/01/new-reporting-framework-will-eliminate-noise-for-bankers-other-financial-statement-users.html
- Twitter hashtag #MainStFinancials: https://twitter.com/search?q=%23MainStFinancials&src=typd
- LinkedIn discussion: www.linkedin.com/groupItem?view=&gid=160517&type=member&type=248768354
- Pinterest: http://pinterest.com/pin/543457880004725517/