Decision Tool for Adopting an Accounting Framework

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Consideration of an Appropriate Accounting Framework

Financial reporting frameworks consist of two groups: generally accepted accounting principles (GAAP), and special-purpose frameworks (SPFs). Special purpose frameworks include cash basis, modified cash basis, tax basis, regulatory basis, contractual basis, and other non-GAAP bases of accounting that utilize a definite set of logical, reasonable criteria that are applied to all material items appearing in the financial statements.

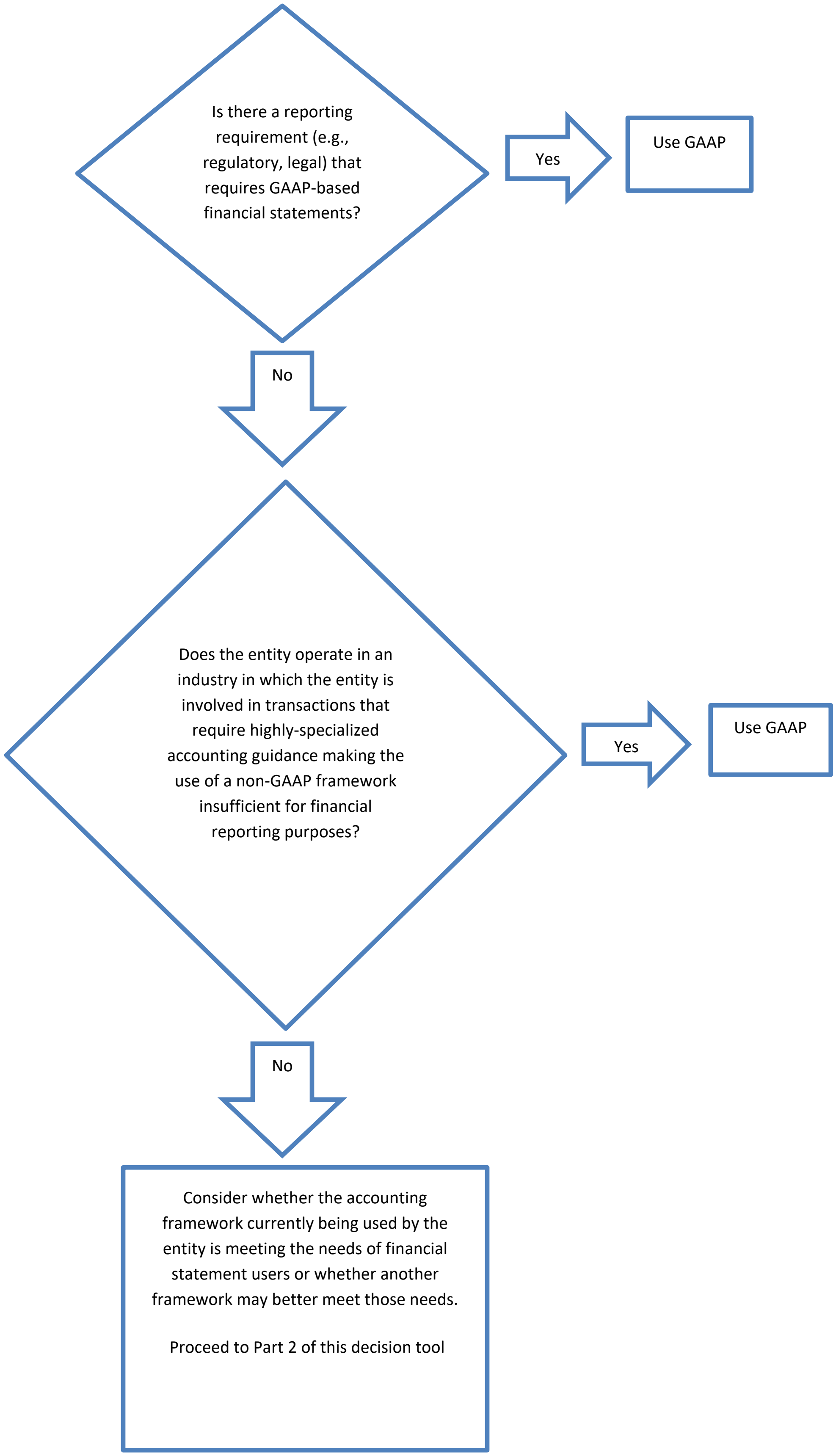
While all of these frameworks can enable credible financial reporting, the choice of an accounting framework is essentially a matter of weighing the features of the different frameworks against the needs of the financial statement users.

Using this Decision Tool

This tool helps owners and managers of a small- or medium-sized private business and CPAs serving those businesses to make an informed decision about choosing an accounting framework, including the FRF for SMEs framework, as an appropriate basis for the preparation of the entity's financial statements. The choice of a financial reporting framework rests with the owners and managers of a private company, in consideration of their needs and the needs of the users of their financial information.

Management of an entity and the CPA practitioners who serve those entities may find this tool helpful in determining which accounting framework (or basis of accounting) is most suitable for the entity's financial reporting needs. By following the steps and assessing the considerations and circumstances outlined in this tool, a more informed decision about the choice of an accounting framework can be made. This tool is presented as a nonauthoritative aid and its use is not required.

Accounting Framework Decision Tool (Part 1)



Accounting Framework Decision Tool (Part 2)

Using Part 2 of the Decision Tool

To facilitate the decision of an appropriate accounting framework, GAAP or a special purpose framework, we have listed below a number of considerations for management to assess. These considerations are separated into four groups:

- Overall considerations
- Considerations Related to GAAP
- Considerations Related to the Cash/Modified Cash and Tax Basis of Accounting
- Considerations Related to the FRF for SMEs Accounting Framework

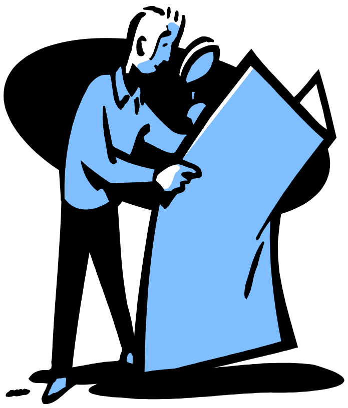
Management's assessment and weighing of these considerations should help determine whether GAAP, FRF for SMEs, cash/modified cash, or the tax basis of accounting is the most suitable accounting framework for an entity.

Overall Considerations

Consideration	Assessed?
The nature of the entity and the purpose of the financial statements	
The users of the financial statements and their financial reporting needs	
The requirements within existing loan covenants and financing arrangements related to the accounting framework used by the entity and the ability to negotiate such requirements	
Cross guarantees with related parties and any implications related to the accounting framework used in preparation of the financial statements	
Other reporting matters and their implications related to the accounting framework used in the preparation of the financial statements. Examples include: • Bonding company reporting requirements • Trade credit grantor (e.g., key suppliers) reporting requirements • Grant documents (e.g., local employment incentive grants)	
Legal agreements or other arrangements and their implications related to the accounting framework used in the preparation of the financial statements. Examples include: • Shareholder agreements • Redemption agreements • Buy out agreements • Stock based compensation agreements (including phantom stock) • Gifting programs • Wills and trusts	
The ability of the accounting framework to result in financial statements that represent the underlying transactions and events in a manner that achieves a fair presentation	
How the various features among accounting frameworks impact the ability to answer the needs of the financial statement users	
Short-term and long-term financial reporting needs of the entity and how that factors into the choice of an accounting framework	

Considerations Related to GAAP

GAAP is a framework of accounting standards, rules and practices authoritatively established by recognized bodies in the United States and abroad. U.S. GAAP for private and public entities is set by the Financial Accounting Standards Board. The Governmental Accounting Standards Board sets U.S. GAAP for state and local governmental entities, and the Federal Accounting Standards Advisory Board sets GAAP for federal governmental entities. The International Accounting Standards Board ("IASB") sets GAAP internationally (International Financial Reporting Standards or IFRS). The IASB has also issued international GAAP for small- and medium-sized entities, which is known as IFRS for SMEs. Both IFRS and IFRS for SMEs are recognized as GAAP in the U.S.



In part I of this decision tool, management of an entity and the CPA who serves the entity assessed whether GAAP-based financial reporting is required or whether the entity's operations involved highly-specialized accounting guidance that necessitated the use of GAAP in the preparation of the entity's financial statements. Beyond those assessments, management or the CPA practitioner may determine that GAAP-based reporting, while not required, may be the best choice for an entity given its particular circumstances. That determination should be based on the needs of the financial statement users and a weighing of the costs and benefits of GAAP-based reporting.

Presented below are two tables. The first table lists circumstances that may indicate a preference for GAAP-based financial reporting. Management or the CPA practitioner may consider these circumstances in evaluating whether GAAP is the most appropriate accounting framework for an entity. The second table lists circumstances that may indicate a preference for the use of IFRS or IFRS for SMEs in financial reporting. These tables are not all-inclusive and there may be other circumstances which point to U.S. GAAP, IFRS or IFRS for SMEs as an appropriate financial reporting choice.

Circumstances That May Indicate a Preference for GAAP-Based Financial Reporting

Circumstance	Considered?
The entity plans to broaden ownership interests in the entity or issue equity in an initial public offering (i.e., go public)	
The entity has significant foreign operations or plans to significantly expand operations globally.	
The entity engages in complex transactions (for example, complicated financial instruments).	
The entity has significant partnership with public companies or other entities that use GAAP-based reporting.	
The entity has the intention of holding itself to public company standards or GAAP.	
The entity competes with public companies for access to credit.	
The entity plans to sell the business to a public company or another entity where GAAP-based reporting is preferred or required.	
The entity is highly-leveraged and significant credit exposure exists for the entity's lender or other external financial statement users.	
The entity plans to access foreign capital or debt markets.	
The entity operates in an industry in which extensive industry-specific accounting rules exist.	
Key users of the entity's financial statements do not have direct access to management.	
Fair-value accounting has significant utility for the financial statement users.	
Topics contained in GAAP and omitted in non-GAAP frameworks (for example, deferred income tax accounting or other comprehensive income) are highly relevant to the entity and its financial statement users.	

Circumstances That May Indicate a Preference for the Use of IFRS or IFRS for SMEs

Circumstance	Considered?
The entity has a foreign parent or subsidiary reporting under IFRS for IFRS for SMEs.	
The entity has significant foreign investors or other capital providers.	
The entity conducts significant business with foreign suppliers, vendors or customers who utilize IFRS or IFRS for SMEs.	
The entity plans to expand overseas or attract international capital suppliers.	

Considerations Related to the Cash/Modified Cash and Tax Basis of Accounting

Factors to consider when evaluating the use of the cash or tax basis of accounting include:

- The users of the financial statements – both internal and external to the entity – understand a cash- or tax-basis presentation and find it relevant for their needs.
- It is cost effective to prepare cash- or tax-basis financial statements.
- The operations of the entity are conducive to a cash or tax-basis presentation.

The tax-basis of accounting is useful for small entities whose financial statement users are interested primarily in the tax aspects of their relationship with the entity. For example, investors in tax-driven partnerships, such as those commonly employed in the real estate industry, may be primarily interested in the tax consequences of transactions.

If certain tax deductions do not accurately reflect the operations of the business, such as SEC 179 depreciation, management may want to consider the FRF for SMEs accounting framework.

The pure cash basis of accounting may be appropriate whenever the entity—

- Is interested primarily in understanding cash flow.
- Has a limited number of financial statement users.
- Has relatively simple operations engaged in one primary activity.
- Does not have significant amounts of debt, fixed assets, or other items that would be recognized under the accrual basis.

Examples of some entities that may use the pure cash-basis of accounting include estates, trusts, civic ventures, student activity funds, and political campaigns and committees.

In practice, the most typical industries in which financial statements prepared in accordance with the cash or tax basis of accounting are issued include professional services, medical, retail, real estate, farming/agricultural, construction, and not-for-profit organizations.

Considerations Related to the FRF for SMEs™ Accounting Framework

Compared to the cash or tax basis of accounting, the FRF for SMEs can provide a more standardized framework and a more comprehensive, integrated set of financial statements, including a cash flow statement and informative disclosures.

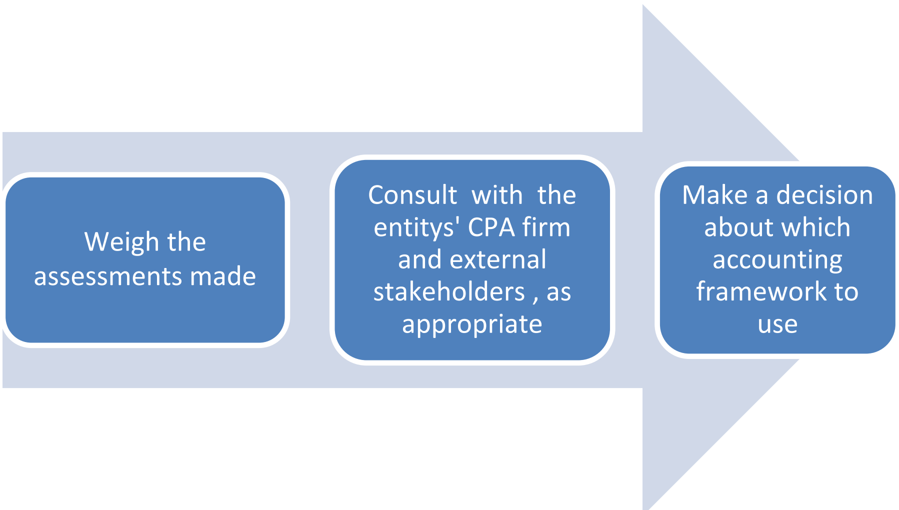
The FRF for SMEs accounting framework has been developed for small-to medium-sized entities that require reliable non-GAAP financial statements for internal use and external uses. The FRF for SMEs task force and AICPA staff believe that this framework can be used by entities in many industry groups and may also be used by unincorporated, as well as incorporated, entities. In deciding whether to use the FRF for SMEs framework, management may consider the characteristics of typical entities using the FRF for SMEs in the table below.

Characteristics Typical of Entities Using the FRF for SMEs (not all inclusive, or required for use of the FRF for SMEs)

Characteristic	Considered?
The entity is for-profit.	
The owners and management of the entity have no intention of going public.	
The entity may be owner-managed, which is a closely held company in which the people who own a controlling ownership interest in the entity are substantially the same set of people who run the company.	
Management and owners of the entity rely on a set of financial statements to confirm their assessments of performance, cash flows, and of what they own and what they owe.	
The entity does not engage in overly complicated transactions.	
The entity does not have significant foreign operations.	
Key users of the entity's financial statements have direct access to the entity's management.	
Users of the entity's financial statements may have greater interest in cash flows, liquidity, statement of financial position strength, and interest coverage.	
The entity's 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 directly related to the financial statements.	

Accounting Framework Decision Tool (Part 3)

Following the steps in Parts 1 and 2 of this tool, and considering other matters and circumstances relevant to an entity can better equip management to decide which accounting framework is most suitable for the financial reporting needs of an entity and its external stakeholders. The final steps in the decision process are:



After the decision of an accounting framework is made, management can periodically reassess its financial reporting needs and reassess whether the accounting framework being used is meeting those needs.