Frequently Asked Questions on the FRF for SMEs™ Framework – Financial Statement Users

1. **Are financial statements prepared in accordance with the FRF for SMEs accounting framework reliable and dependable?**

   Yes. The FRF for SMEs accounting framework was built by the CPA profession and underwent public exposure and professional scrutiny. The development process considered the needs of financial statement users, including bankers, and involved the participation of CPAs possessing years of experience serving Main Street businesses. The resulting accounting principles comprising the FRF for SMEs are intended to be the most appropriate for the preparation of a smaller business's financial statements.

2. **How does the FRF for SMEs accounting framework benefit financial statement users?**

   Financial statement users, such as bankers, sureties and other interested parties, need financial information that is relevant and clear so they can make informed decisions. In addition, they want to help customers realize cost-savings and efficiencies where possible. The FRF for SMEs framework delivers on both of those points. Stakeholders who receive financial statements prepared under the FRF for SMEs will find relevant information they need to understand the company and its finances. It will enable bankers and other financial statement users to help their customers because use of the framework by small- and medium-sized businesses is cost-effective. The bottom line is the financial statement users get the information they need to make a credit or business decision while the company potentially saves money.

3. **Will the FRF for SMEs deliver the information I need in a set of financial statements?**

   The FRF for SMEs is intended to yield comprehensive, traditional, accrual-based financial statements, including a statement of financial position, statement of operations, statement of changes in equity and a statement of cash flows. In addition, sufficiently informative note disclosures are required. The financial reports prepared in accordance with the FRF for SMEs are meant to present only relevant and understandable information to financial statement users, without unnecessary complexity and extraneous narrative and details.

4. **How does the FRF for SMEs differ from other bases of accounting?**

   The FRF for SMEs is a non-GAAP ("generally accepted accounting principles") accounting framework. Other non-GAAP frameworks include the income tax basis of accounting and the cash basis of accounting. The FRF for SMEs is different in that it has undergone public exposure and professional scrutiny, and provides standardized financial reporting. The FRF for SMEs framework offers an integrated financial picture of a business, providing, among other things, a statement of cash flows and informative disclosures. The FRF for SMEs provides robust financial information to enable a financial statement user to assess a company's liquidity, financial flexibility and operating capabilities.

The principles and criteria comprising the FRF for SMEs accounting framework differ from GAAP in that the FRF for SMEs is tailored for the small business community and targeted to their specific financial reporting needs and those of their bankers and other external stakeholders. In addition, unlike GAAP, the FRF for SMEs generally does not make use of fair value accounting and also provides more flexibility in the areas of accounting for income taxes and consolidations.

5. Why is the FRF for SMEs needed at this time?

The AICPA's recent efforts to improve private company financial reporting revealed a clear need by small- and medium-sized businesses for a new non-GAAP framework to better suit and answer their financial reporting needs. While some small businesses have found the cash or tax basis of accounting acceptable, these bases may be insufficient or inappropriate for other companies or users looking for more comprehensive and consistent financial information. The FRF for SMEs accounting framework solves this marketplace demand by offering a cost-effective non-GAAP financial reporting option that is relevant, robust and reliable.

6. How is the FRF for SMEs guidance different from what the FASB and its Private Company Council is doing with regard to private company accounting?

The Private Company Council, established by the Financial Accounting Foundation, works jointly with the Financial Accounting Standards Board to propose exceptions or modifications to U.S. GAAP to address the needs of users of private company financial statements. The AICPA's FRF for SMEs is a non-GAAP framework intended to be used by small- and medium-sized entities that are not required to prepare GAAP-based financial statements. Therefore, the PCC and the FRF for SMEs framework are two separate but complementary initiatives aimed at improving private company financial reporting.

7. In what situations should a small- or medium-sized business prepare its financial statements in accordance with the FRF for SMEs instead of another basis of accounting?

It comes down to each small business making an individual decision about what constitutes the best financial reporting option for themselves and those who rely on their financial statements. Deciding on using the FRF for SMEs should not be a complicated or difficult decision for a business's owner-manager, its outside CPA firm and external financial statement users to make. External stakeholders, such as a banker or surety, will need to meet with the small business customer and its CPA firm to comfortably understand why the FRF for SMEs may be the better financial reporting option for the customer as well as the external stakeholder. The CPA firm will be equipped to explain the financial reporting under the framework and to demonstrate the kind of financial statements and information that external parties will receive.

When GAAP is not required and when the income tax basis or cash basis is not sufficient, the FRF for SMEs framework can be an ideal option for owner-managers and external stakeholders who need financial statements that focus on cash flow and contain only relevant disclosures and financial metrics.

8. **Bankers and other financial statement users often need information about subsidiary, affiliate and parent cash flows. Would the FRF for SMEs provide this information?**

   The FRF for SMEs accounting framework would require disclosure of subsidiary, affiliate and parent financial information. In being more tailored to the needs of smaller businesses and their financial statement users, the FRF for SMEs looks at control through ownership rather than at variable interests and allows parent-only financial statements to be prepared. This concept makes sense to small business owners and their bankers because it gets to what they own. In addition, the framework does require disclosure of related-party activities, which are so common among small businesses.

9. **Main Street businesses often offer their tax returns as financial information to lenders and other stakeholders. Could the accounting information required by the FRF for SMEs framework be derived from the same information needed for the tax return?**

   Yes. One of the goals in developing the FRF for SMEs was to reduce the amount of difference between an entity's financial statements and its tax return. The framework is based on traditional accounting methods blended with accrual income tax methods. The end result is a much greater matching of book and tax reporting. We found that very often a tax return is not sufficient for financial reporting purposes for small business stakeholders. In those cases, the FRF for SMEs can be a very useful alternative, providing a more comprehensive and decision-useful financial picture of the entity.

10. **How is the FRF for SMEs a cost-effective reporting option for a small business?**

    The FRF for SMEs framework consists of accounting principles that are especially suited and relevant to a typical small business. For example, the framework uses historical cost as its measurement basis and steers away from complicated and costly fair value measurements; the framework offers a simplified consolidation model; the framework does not require complicated accounting for derivatives, hedging activities or stock compensation; and the framework's disclosure requirements are targeted without excess narrative. Moreover, the FRF for SMEs is concise and understandable, and will be a stable framework. These factors and others produce a reporting option that is cost-effective for many entities.

11. **Will bank examiners effectively prevent bank lenders from accepting financial statements under the FRF for SMEs framework as supporting documentation in the loan files?**

    The AICPA understands, and observations to date support this understanding, that bank examiners view FRF for SMEs as another form of non-GAAP frameworks (such as cash basis and income tax basis). Such forms of non-GAAP financial statements have been supporting documentation in loan files for many decades.

12. Have lenders, sureties and other stakeholders accepted financial statements prepared using the FRF for SMEs?

Yes. Lenders generally have been receptive to learning about FRF for SMEs, and in a number of situations accepted financial statements prepared using the framework. A recent article by the editor of the American Bankers Association's Banking Journal highlighted the framework and deemed it a tool banks should consider for staying competitive in the marketplace.