



An Introduction to the Financial Reporting Framework for Small and Medium-Sized Entities

for financial statement users



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Why develop the FRF for SMEs accounting framework?

Recent efforts by the U.S. accounting profession to provide additional financial reporting options for private companies revealed a clear and strong demand by small and medium-sized entities (SMEs), the CPAs who serve them, and those who use their financial statements for a more robust and reliable accounting framework when GAAP is not required. These stakeholders expressed a need for a framework that is targeted to Main Street businesses. Other special-purpose frameworks, such as income tax or cash bases of accounting, remain and could be appropriate. Main Street businesses and users of their financial information looking for more comprehensive and consistent financial statements may want to explore the FRF for SMEs™ reporting option.



In response to that marketplace demand, American Institute of CPAs (AICPA) staff and a task force consisting of CPA practitioners and a representative from the banking community developed the FRF for SMEs accounting framework. It is a non-GAAP special purpose framework developed by the CPA profession, underscoring the CPAs' role as trusted business advisers for America's small business community.

What types of organizations may want to use the FRF for SMEs accounting framework?



The FRF for SMEs accounting framework has been developed for small to medium-sized entities that require reliable non-GAAP financial statements for internal and external uses. This framework can be used by entities, whether incorporated or unincorporated, in many industry groups.

What is a small and medium-sized entity (SME)?

There is no set quantifiable definition in the United States (dollar amount of revenues, number of locations, etc.) for determining what an SME is. However, the term is intuitive, widely recognized and effectively descriptive of the scope of entities for which the FRF for SMEs accounting framework is intended. AICPA staff and the task force identified certain characteristics of typical entities that might utilize the framework. The following is a list of those characteristics to consider. This list is not all-inclusive and an entity does not have to have these characteristics to use the framework.

Characteristics of small and medium-sized entities utilizing the FRF for SMEs accounting framework

- The entity may be closely held and owner-managed.
- The entity does not have regulatory reporting requirements that essentially require it to use GAAP-based financial statements.
- The entity is for-profit.
- Most of the owners and management of the entity have no intention of going public.

- 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 operate in an industry in which the entity is involved in transactions that require highly specialized accounting guidance, such as financial institutions and governmental entities.
- 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.

These characteristics are presented as helpful guidelines for management and other stakeholders to consider when determining the appropriateness and suitability of the FRF for SMEs accounting framework in the preparation of financial statements. Ultimately, the decision regarding which accounting framework best meets an entity's financial reporting needs rests with management. The FRF for SMEs accounting framework should only be used if the resulting financial statements are intended to be consistent with the concepts, principles, and criteria described in Chapter 1 of Financial Reporting Framework for Small and Medium-Sized Entities.

The framework is not intended to be a substitute for GAAP when GAAP-based financial statements are necessary, as determined by the management of an entity and its financial statement users (i.e., bankers, sureties, etc.).

The AICPA has no authority to prevent or require the use of a special purpose framework like the FRF for SMEs accounting framework.

Benefits to stakeholders



The FRF for SMEs framework is designed specifically to suit the needs of small and medium-sized entities and their stakeholders.

Owner-managers of small businesses need reliable financial information to inform their business decisions and outside stakeholders. They need ways to work smarter, control costs and gain strategic operational insights. While GAAP and the other special purpose frameworks serve a valuable purpose, the FRF for SMEs provides another non-GAAP alternative. The FRF for SMEs framework assists small business owner-managers and other stakeholders in focusing on the performance of the company and its assets, liabilities, and cash flows. Moreover, the FRF for SMEs is a cost-effective, simplified financial reporting framework with targeted disclosure requirements.

Management of smaller to medium-sized private companies may find the FRF for SMEs framework an appealing financial reporting option because it closely aligns with how they run their businesses.

Some of the key advantages of FRF for SMEs include:

- Historical cost is the primary measurement basis, steering away from complicated fair value measurements.
- Financial statements will more closely align with income tax returns because there will be fewer book-to-tax adjustments.
- Many accounting policy options, like the ability to choose the current taxes payable method or the deferred tax method, will allow management to select what is best for their purposes and those of their financial statements users and potentially reduce costs.
- The framework is concise and self-contained without excess narrative and prescriptive rules (the entire FRF for SMEs accounting framework is approximately 200 pages).

- The framework will be stable, yet nimble. Frequent changes to the framework are not contemplated, however it will be modified in response to significant developments in accounting and financial reporting matters affecting SMEs.
- Only relevant principles are included and the accounting is simplified.
 - No other comprehensive income (OCI)
 - No variable interest entities (VIEs); parent-only financial statements are allowed
 - No complicated accounting for stock compensation and derivatives
 - No hedge accounting
- Disclosures are targeted and not excessive.
- Accounting for long-lived assets follows an amortized/depreciated cost approach. No impairment testing is required.
- Goodwill is amortized over the same period as for federal tax purposes. No impairment testing is required.

Bankers, surety companies and other financial statement users who receive financial statements prepared based on 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.

More specifically, bankers and other users need financial statements that are prepared in a reliable and consistent manner in accordance with a framework that has undergone public comment and professional scrutiny. The FRF for SMEs is that kind of framework. The accounting principles composing the FRF for SMEs are intended to be the most appropriate for the preparation of a smaller business's financial statements based on the needs of bankers and other users.

GAAP

The FRF for SMEs is the tool to prepare streamlined, relevant financial statements for privately held small and medium-sized entities that do not need GAAP-compliant reports. With this tool, a CPA can prepare financial statements that clearly and concisely report what a business owns, what it owes and its cash flow. Lenders and others can clearly understand key measures of a business and its credit-worthiness. The framework consists of traditional accounting principles and accrual income tax accounting methods that are very familiar to lenders and other users and should be welcomed as an insightful alternative reporting framework.

Key features of the FRF for SMEs accounting framework

Historical cost

Uses historical cost basis, steering away from complicated fair value measurements

Optionality

Offers tailored reporting to meet user needs

Relevant

Includes only financial reporting topics typically encountered by small businesses

Simplified

Avoids complicated, prescriptive rules

Targeted disclosures

Provides what a user needs to see in financial statements



Additional resources

Learn more about FRF for SMEs by checking out the additional resources the AICPA developed to help small- to mid- sized private businesses and interested parties understand the framework. You'll find these and other tools at aicpa.org/FRF-SMEs:

- Free download of the framework
- Implementation guidance including
 - Illustrations of the application of certain principles and criteria of the FRF for SMEs
 - Disclosure checklists
- PowerPoint you can use to explain the framework to
 - Others in your practice
 - Clients and financial statement users
- Summary comparison of FRF for SMEs to other bases of accounting
- Short video explaining the benefits of the framework
- Illustrative financial statements to give you an idea of what financials might look like for businesses using the FRF for SMEs
- Sample communications to help explain the framework to clients, bankers and other financial statement users
 - Letters
 - Newsletter articles
 - Social media posts (LinkedIn, Twitter, Facebook and Foursquare)
- Frequently asked questions
- Logo to promote your firm's new service offering

Check the website frequently to explore new resources, training opportunities and more: aicpa.org/FRF-SMEs.

You can also follow the conversation on Twitter at [#MainStFinancials](https://twitter.com/MainStFinancials).

If you have further questions, email us at FRFforSMEs@aicpa.org.

Technical hotline

AICPA members with technical questions about the FRF for SMEs may call the Accounting and Auditing Technical Hotline at [888.777.7077](tel:888.777.7077), menu option No. 5, followed by menu option No. 3. You may also submit questions to the online Accounting and Auditing Technical Hotline.



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