

Acquisition of Subsidiary using Both Private Company Council and Public Company Accounting

James Penner

Western Michigan University

Cari Burke-Kolehmainen

Western Michigan University

Jerry Kreuze

Western Michigan University

Abstract

In 2012, the Financial Accounting Foundation (parent of the Financial Accounting Standards Board (FASB)) created the Private Company Council (PCC) to address the complexity of financial accounting and reduce reporting requirements for private companies. This case introduces undergraduate and graduate accounting students to the PCC standards tailored for private companies, including the calculation of intangible assets, the preparation of investment journal entries, the preparation of consolidation worksheet entries, and the comparison of subsidiary equity income between private and public company GAAP. This case also provides students the opportunity to evaluate the choices management has in deciding which form of US GAAP to implement, by determining eligibility for election of the tailored private company standards, assessing the value of such standards to financial statement users, and determining the different circumstances under which private companies should and should not elect such tailored standards. Overall, the case helps students become aware of the issues and complexities of private company accounting and acquisitions that management should consider when deciding whether to elect the accounting alternatives provided by the PCC. The ensuing discussion centers on these presentation and accounting differences, using the case of an IPO as an example.

Keywords: Private Company Council, Acquisitions, Consolidation

Case Background

“The CPA profession has been debating the concept of separate accounting standards for closely held businesses for over 40 years” (Mastracchio and Lively, 2017, p. 50). In 2012, the Financial Accounting Foundation (parent of the Financial Accounting Standards Board (FASB)) created the Private Company Council (PCC) to address the complexity of financial accounting and reduce some of the reporting requirements by tailoring US GAAP for private companies. The FASB and the PCC have identified five significant factors that differentiate reporting demands of private from public companies: 1) the number of primary financial statement users and their access to management, 2) the investment strategies of primary users, 3) the ownership and capital structures, 4) accounting resources, and 5) the manner in which preparers learn about new financial reporting guidance. Public companies answer to investors (both shareholders and lenders), hedge funds and private equity groups, while private firms’ financial statements are largely used by owners, potential owners, and lenders, who typically have other avenues to obtain information if

needed. Prior to issuing any changes to US GAAP, the Private Company Council is required to get approval from the FASB. Proponents of tailored reporting standards for private companies argue that the information demands of private companies vary from those of public companies and that the costs outweigh the benefits of following full US GAAP (hereafter referred to as public company GAAP) for most private companies (e.g., Bradshaw et al., 2014). Prior literature documents the controversy over private company reporting requirements and recognizes that neither the PCC standards nor the competing AICPA Financial Reporting Framework for Small and Medium Sized Entities framework have become standard across the board (e.g., Habib, Ranasinghe, & Huang, 2018), nor is there universal acceptance of the idea that the benefits of tailored reporting standards for private companies outweigh the costs, consistent with slow adoption of such standards (e.g., Bradshaw et al., 2014; Lynch, 2012; Mastracchio and Lively, 2017). Prior literature also documents the potential cost to private companies who switch from private company GAAP to public company GAAP upon the initiation of an IPO, which is the case in point (e.g., Kordecki & Bullen, 2014).

Let Us Get Started: Case Information, Part 1

You are an accountant at Rein LLC, a private environmental service company, where you work closely with the CFO, Robin Davis. Your primary task is simplifying the accounting function within company operations to minimize costs and to ensure appropriate financial statement disclosures and information. To expand company operations and to create more industry diversity, Rein invested \$100 million to purchase 100% of Lester Company on January 1, 2024. Lester Company manages sales and use tax accounting and reporting for small and medium sized businesses. Rein applied the acquisition method for this acquisition and, based on PCC rules, can apply the equity method, the partial equity method, or the initial value method to account for the investment in the subsidiary. At the time of the acquisition, Lester Company had the following assets and liabilities:

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$10,000,000	Accounts Payable	\$5,000,000
Property, Plant, & Equipment	<u>20,000,000</u>	<u>Stockholders' Equity</u>	
		Common Stock	24,000,000
		Retained Earnings	<u>1,000,000</u>
Total Assets	<u>\$30,000,000</u>	Total Liabilities and Stockholders' Equity	<u>\$30,000,000</u>

Not reported on the balance sheet, Lester Company had unrecorded costs associated with a patent, presently valued at \$20,000,000 with a 5-year remaining useful life and a customer list valued at \$15,000,000 with a 15-year remaining useful life. When collecting the customer list, Lester Company agreed not to sell any customer information to third parties. Since Rein is a private company, it has elected to use the accounting alternatives presented by the Private Company Council (PCC) (<http://www.fasb.org/pcc>). As the accountant for Rein, you have identified ASU 2014-02 as well as ASU 2014-18 as relevant standards for this acquisition using the guidance under the Private Company Council. During 2024, Lester Company recorded net income of \$10,000,000 and paid a dividend of \$4,000,000 all of which went to Rein, as it is a 100% owner. During 2025, Lester Company recorded net income of \$20,000,000 and paid a dividend of \$7,000,000 to Rein.

Requirements:

For all of your answers please provide calculations and support from the Accounting Standards Codification or from the Accounting Standards Updates (ASU's).

1. How much goodwill will be recorded from this acquisition? (Please show your work).
2. Prepare the journal entries for Rein's investment in Lester Company as of December 31, 2024 and December 31, 2025 for Rein, following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.

3. Prepare the consolidation worksheet entries that Rein would make for Lester Company for December 31, 2024 and December 31, 2025, again following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.
4. The CFO of Rein, Robin Davis, has asked for your opinion about whether electing private company GAAP improves the financial information available to its financial statement users as opposed to following public company GAAP. Prepare your response, including the reasoning supporting that position, as a formal business memo addressed to the CFO of Rein.

Continuing Our Investigation: Case Information, Part 2

You have spent the last 2 years with Rein and have seen Rein expand into a nationwide phenomenon, partially due to its investment in Lester Company. On December 31, 2025, Rein has decided to go through an initial public offering (IPO). On December 31, 2025, Rein and Lester reported the following asset and liability amounts prior to any adjustments made for the Securities and Exchange Commission (SEC) Initial Public Offering (IPO) filings.

Equity Method Balance Sheet

<u>Assets</u>	<u>Rein</u>	<u>Lester</u>
Cash	\$50,000,000	\$29,000,000
Property, Plant, & Equipment	60,000,000	20,000,000
Investment	100,000,000	-
Patent	-	-
Customer List	-	-
Goodwill	-	-
Total Assets	<u>\$210,000,000</u>	<u>\$49,000,000</u>
<u>Liabilities</u>		
Accounts Payable	\$40,000,000	\$5,000,000
<u>Stockholders' Equity</u>		
Common Stock	100,000,000	24,000,000
Retained Earnings	<u>70,000,000</u>	<u>20,000,000</u>
Total Liabilities and Stockholders' Equity	<u>\$210,000,000</u>	<u>\$49,000,000</u>

Partial Equity Method Balance Sheet

<u>Assets</u>	<u>Rein</u>	<u>Lester</u>
Cash	\$50,000,000	\$29,000,000
Property, Plant, & Equipment	60,000,000	20,000,000
Investment	119,000,000	-
Patent	-	-
Customer List	-	-
Goodwill	-	-
Total Assets	<u>\$229,000,000</u>	<u>\$49,000,000</u>
<u>Liabilities</u>		
Accounts Payable	\$40,000,000	\$5,000,000
<u>Stockholders' Equity</u>		
Common Stock	100,000,000	24,000,000
Retained Earnings	<u>89,000,000</u>	<u>20,000,000</u>
Total Liabilities and Stockholders' Equity	<u>\$229,000,000</u>	<u>\$49,000,000</u>

<u>Initial Value Method Balance Sheet</u>		
<u>Assets</u>	<u>Rein</u>	<u>Lester</u>
Cash	\$50,000,000	\$29,000,000
Property, Plant, & Equipment	60,000,000	20,000,000
Investment	100,000,000	-
Patent	-	-
Customer List	-	-
Goodwill	-	-
Total Assets	<u>\$210,000,000</u>	<u>\$49,000,000</u>
<u>Liabilities</u>		
Accounts Payable	\$40,000,000	\$5,000,000
<u>Stockholders' Equity</u>		
Common Stock	100,000,000	24,000,000
Retained Earnings	<u>70,000,000</u>	<u>20,000,000</u>
Total Liabilities and Stockholders' Equity	<u>\$210,000,000</u>	<u>\$49,000,000</u>

Requirements:

For all of your answers please provide calculations and support from the Accounting Standards Codification or from the Accounting Standards Update (ASU's)

1. Calculate the following account balances as of December 31, 2025 assuming the company has followed private company GAAP, has used the method of accounting for subsidiaries selected by your instructor for Part 1 (Equity Method, Partial Equity Method, or Initial Value Method), and has not made any adjustments for the upcoming IPO:
 - a. Goodwill
 - b. Patent
 - c. Customer List
2. If Rein decides to go through an IPO, is it allowed to continue using guidance from the Private Company Council? If no, why not?
3. Recreate the journal entries for Rein's investment in Lester Company as of December 31, 2024 and December 31, 2025 for Rein for the SEC prospectus as of December 31, 2025, following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.
4. Prepare the consolidation worksheet entries that Rein would make for Lester Company for December 31, 2024 and December 31, 2025 for the SEC prospectus, again following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.
5. In the filing with the SEC, provide the calculations for the amount of equity income Rein would recognize from the Lester Company subsidiary as of December 31, **2024**. How does this differ from the amounts originally created in Part 1 of the case study?
6. In light of the changes related to the potential IPO, the CFO of Rein, Robin Davis, has once again asked for your opinion about whether electing accounting alternatives provided by the Private Company Council improves or worsens financial information and financial reporting for private companies as opposed to when private companies use public company GAAP. Prepare your response, including the reasoning for that opinion, as a formal business memo addressed to the CFO.
7. When commencing a private company, would you choose to elect one or more Private Company Council accounting alternatives? Identify some of the circumstances, if any, when you would be (a) likely and (b) unlikely to elect private company GAAP. Prepare your response, including the reasoning for your response, as a formal business memo addressed to your instructor.

TEACHING NOTES

Case Overview

This case fills a gap, or expands the discussion, in many accounting curricula by teaching the accounting alternatives made possible by the Private Company Council (PCC). Ramanna and Viceira (2013/2016) provide students the opportunity to consider whether such standards should have been implemented, but no case studies provide students with the opportunity to examine whether implementation of such standards provides a net cost or benefit for individual private companies. Lively and Mastracchio (2012) explicitly acknowledge the need for curricula to address the practical use of multiple accounting frameworks, including US GAAP, IFRS, and private company frameworks. “Because today’s students will make up tomorrow’s workforce, it is important for firms to remain aware of these educational developments” (Lively and Mastracchio, 2012, p. 65). This case focuses on PCC accounting alternatives in order to introduce students to such frameworks and allow them to explore the benefits and potential costs of such a framework when a company later implements an IPO and has to retrospectively restate financial information under public accounting GAAP.

Learning Objectives

The specific learning objectives for the case are as follows:

Bloom’s Taxonomy Level	Learning Objective	Part 1 Questions (Private Company Accounting)	Part 2 Questions (Public Company Accounting)
Apply	LO 1: Calculate intangible asset amounts, appropriately applying private company or public company GAAP	1	1
Apply	LO 2: Prepare investment journal entries, appropriately applying private company or public company GAAP	2	3
Apply	LO 3: Prepare consolidation worksheet entries, appropriately applying private company or public company GAAP	3	4
Analyze	LO 4: Compare the difference in the amount of subsidiary equity income recorded using private company GAAP vs. public company GAAP		5
Evaluate	LO 5: Assess the value of private company GAAP vs. public company GAAP for investors and financial statement users	4	6
Evaluate	LO 6: Determine whether Rein will be eligible to elect private company GAAP if it decides to go through an IPO		2
Evaluate	LO 7: Determine whether you would choose to elect private company or public company GAAP for a private company		7

Case Description and Overview

This case introduces students to the PCC and the corresponding discussions about the complexity of accounting and whether or not US GAAP is too detailed and onerous for small and medium sized entities. This case also highlights some of the decisions that managers of private companies must make in deciding whether they should adopt the

new alternatives issued by the PCC. That is, private companies are free to adopt any of the PCC standards, as they can choose which ones they wish to follow and when those standards are adopted.¹

Prior to adoption of PCC accounting alternatives, private companies must consider cost of capital implications, costs of adoption, and potential restatements. Consultations with present and future creditors and investors should be undertaken to determine if they have concerns with PCC standards. While PCC standards are designed to reduce complexity of accounting and the thorny issues of accounting for private companies, their adoption can cause comparability and growth concerns.

Some of the first changes to private company accounting include the accounting for intangible assets from acquisitions, derivative accounting around 'plain vanilla' interest rate swaps, and the accounting for goodwill. This case explores the issues around the intangible assets from acquisitions, the amortization of goodwill, and the complexities and issues around the mandatory switching from private company GAAP to public company GAAP that is required with an IPO initiation.

This case contains two parts. The first part requires students to account for an acquisition of a subsidiary using the accounting alternatives created by the PCC. To begin, the instructor must select a method of accounting for subsidiaries (Equity Method, Partial Equity Method, or Initial Value Method) for the students to use. Next, students must determine the proper accounting for a non-transferable customer list, an unrecorded patent, and goodwill from an acquisition. Once students have determined the amounts for each of these potential assets, they are required to determine the amortization of goodwill. For private company GAAP, goodwill may be amortized on the straight-line basis over 10 years and tested for impairment when a triggering event occurs, rather than carrying goodwill at its original value and testing for impairment annually. Moreover, private company GAAP allows companies to include in goodwill customer-related intangible assets that are not capable of being sold or licensed separately from the rest of the business and noncompetition agreements. In addition, students must create the journal entries required for a subsidiary applying the Equity Method, the Partial Equity Method, or the Initial Value Method. The authors require students to complete the case using the Equity Method as that is the focus of the class up to that point. Lastly, students provide their opinion on whether the costs and benefits from the alternatives provided by the PCC are favorable and create better financial reporting as compared to public accounting GAAP.

The second part of the case requires students to create financial statements for two years after the acquisition using public company GAAP. In creating the financial statements for Rein, students are required to retrospectively calculate amounts for the customer list, the patent, and goodwill, showing the required amortization for two years. In addition, students must present how the financial statements for Rein will change once the company decides to become a public company. This step requires preparing necessary journal entries to 'unwind' the accounting transactions recorded using the PCC accounting alternatives.

The conversion, in reality, would require the financial results to be redrafted, restated, and re-audited for the company, perhaps up to three years back. These potential restatements have caused some to argue that separate private company GAAP may increase costs to the capital markets. In voting against the change for intangible assets, James Kroeker, vice chairman of the FASB, stated that "a difference between public and private, we're actually increasing the potential cost of capital for the system as a whole. I think we're going to create impediments within our capital markets to the growth of capital in the US" (CFO, November 25, 2014).

Clearly, before adopting PCC proposals, a private company must strongly consider its present situation and any potential areas of expansion or changes in ownership. Future capital needs, potential acquisitions, issuing debt, or an IPO must be a consideration. If these events are possible, adoption of any PCC standards should be seriously

¹ In 2016, the FASB issued ASU 2016-03, which eliminates effective dates for ASU PCC accounting alternatives and allows companies electing a PCC alternative for the first time after the alternative's effective date to forego the otherwise required preferability assessment under Accounting Standards Codification (ASC 250). However, any subsequent changes to PCC elections will still require justification that the change is preferable under ASC 250.

considered and may not be advisable. Students, in completing this case, will become aware that these restatements can be challenging and will add costs and complexity to reporting. The potential confusion to its existing investors and creditors may be a consideration as well.

Implementation Guidance

This case is designed for, and has been field tested in, an undergraduate advanced accounting course. In addition, we believe this case could be used in a graduate-level course in which consolidations are covered. We say that because in the course field tested, there were graduate students enrolled. Those students engaged and perceived value from the case. Regardless, the case will need to be completed after students have gained an understanding of acquisitions and subsequent consolidations. It is not necessary for students to have covered the non-controlling interest, inter-company asset or liability transactions. Students are not expected to have been introduced to the Private Company Council or any of the guidance issued by that organization. However, an introduction to the PCC would not adversely impact the case benefits. Regardless, the case includes the relevant Accounting Standard Updates that students will have to consider when applying the guidance from the Private Company Council.

The case was assigned as a group assignment after the consolidation chapters were covered in advanced accounting and provided one last review of consolidations before the final exam. The case is textbook independent, so any textbook covering consolidations is appropriate. But what is critical is for this to be distributed after consolidations issues have been introduced and discussed. On average, students spent a reasonable amount of time on the case, approximately ten hours. The individual sections of the case provided significant guidance to the students on which Accounting Standard Updates to research. The case rather could be completed as an individual project, with the instructor adding assistance when needed by students. Some assistance and guidance by the instructor can be expected, as students may or may not have been fully exposed to PCC guidelines. Alternatively, the first part of the case could be an individual project, and the transition to public company GAAP a group project, as the restatement perhaps adds greater complexity for students. Due to the time required to complete, the case, in totality or in part, should be completed outside of class time. Nevertheless, some class time may be appropriate for the instructor to have an initial discussion and perhaps continuing discussion of the case as deemed appropriate. To facilitate this classroom discussion, the faculty printed out the cover page, table of contents and summary for the two relevant ASU's (while telling the students the amendments to the codification and basis for conclusion are available online for a more detailed discussion). The faculty member also provided guidance and instruction on how to read and comprehend FASB guidance. However, it is necessary for the students to critically think and identify how these amendments to the codification are going to impact this company.

If this case is assigned to a graduate-level class, the reference to the two relevant ASU's can be removed in order, at the instructor's discretion, to require students to research the topic in more detail. Regardless, the results from the case require students to display a high level of understanding on how to implement the requirements under the Private Company Council and to demonstrate they fully understand the differences between those two GAAP pronouncements. This understanding and implementation of how PPC requirements impact consolidated financial statements, in most cases, is not realized in traditional course coverages, allowing this case to expand the learning of students.

Recommended Solutions

Case Solutions – Part 1

Question 1 (LO 1: Calculate intangible asset amounts, appropriately applying private company or public company GAAP)

How much goodwill will be recorded from this acquisition?

Purchase Price	\$100,000,000
Book Value	\$25,000,000*
Excess over Book Value	\$75,000,000

Allocation of excess of fair value over book value to intangible assets:

Patent	\$20,000,000	(5-year useful life)
Customer List**	\$0	
Goodwill***	\$55,000,000	(10-year useful life)

* The book value of the company is calculated as the assets – liabilities or the total stockholders' equity of Lester Company.

** Accounting Standard Update 2014-18 allows for private companies to elect an accounting alternative to not recognize the fair value of certain intangible assets separately from goodwill. These intangibles include customer-related intangible assets and noncompetition agreements. If a company elects to use 2014-18 it must elect to use ASU 2014-02 (Accounting Standards Codification (ASC) 805-20-25-30).

*** Accounting Standard Update 2014-02 allows for private companies to elect an accounting alternative to amortize goodwill over a period of no more than 10 years (ASC 350-20-35-63). If companies do not choose to elect 2014-18, they can choose to adopt 2014-02 or not.

Question 2 (LO 2: Prepare investment journal entries, appropriately applying private company or public company GAAP)

Prepare the journal entries for Rein's investment in Lester Company as of December 31, 2024 and December 31, 2025 for Rein, following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.

Equity Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000
	*To record the purchase of the investment		
12/31/2024	Investment	10,000,000	
	Equity in Subsidiary Earnings		10,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2024	Cash	4,000,000	
	Investment		4,000,000
	*To record the subsidiary cash dividend		
12/31/2024	Equity in Subsidiary Earnings	9,500,000	

Investment	9,500,000
*To recognize amortization on allocations made in acquisition of subsidiary, (patent \$4,000,000 and goodwill 5,500,000)	

Equity Method Accounting Journal Entries for 2025

12/31/2025	Investment	20,000,000	
	Equity in Subsidiary Earnings		20,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2025	Cash	7,000,000	
	Investment		7,000,000
	*To record the subsidiary cash dividend		
12/31/2025	Equity in Subsidiary Earnings	9,500,000	
	Investment		9,500,000
	*To recognize amortizations on allocations made in acquisition of subsidiary (patent \$4,000,000 and goodwill 5,500,000)		

Partial Equity Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000
	*To record the purchase of the investment		
12/31/2024	Investment	10,000,000	
	Equity in Subsidiary Earnings		10,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2024	Cash	4,000,000	
	Investment		4,000,000
	*To record the subsidiary cash dividend		

Partial Equity Method Accounting Journal Entries for 2025

12/31/2025	Investment	20,000,000	
	Equity in Subsidiary Earnings		20,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2025	Cash	7,000,000	
	Investment		7,000,000
	*To record the subsidiary cash dividend		

Initial Value Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000
	*To record the purchase of the investment		
12/31/2024	Cash	4,000,000	
	Dividend Income		4,000,000
	*To record the subsidiary cash dividend		

Initial Value Method Accounting Journal Entries for 2025

12/31/2025	Cash	7,000,000	
	Dividend Income		7,000,000

*To record the subsidiary cash dividend

Question 3 (LO 3: Prepare consolidation worksheet entries, appropriately applying private company or public company GAAP)

Prepare the consolidation worksheet entries that Rein would make for Lester Company for December 31, 2024 and December 31, 2025, again following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.

Equity Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2024	Patent	20,000,000	
	Goodwill	55,000,000	
	Investment		75,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2024	Equity in Subsidiary Earnings	500,000	
	Investment		500,000
	*To eliminate the impact of intra-entity subsidiary income		
12/31/2024	Investment	4,000,000	
	Dividend		4,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2024	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000
	*Recognize the excess amortization expenses for the current year		

Equity Method Consolidation Worksheet Entries for 2025

12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2025	Patent	16,000,000	
	Goodwill	49,500,000	
	Investment		65,500,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2025	Equity in Subsidiary Earnings	10,500,000	
	Investment		10,500,000
	*To eliminate the impact of intra-entity subsidiary income		
12/31/2025	Investment	7,000,000	
	Dividend		7,000,000

*To eliminate the impact of intra-entity subsidiary dividends paid to Rein

12/31/2025	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000

*To recognize the excess amortization expenses for the current year

Partial Equity Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000

*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein

12/31/2024	Patent	20,000,000	
	Goodwill	55,000,000	
	Investment		75,000,000

*To recognize the unamortized allocations as of the beginning of the year

12/31/2024	Equity in Subsidiary Earnings	10,000,000	
	Investment		10,000,000

*To eliminate the impact of intra-entity subsidiary income

12/31/2024	Investment	4,000,000	
	Dividend		4,000,000

*To eliminate the impact of intra-entity subsidiary dividends paid to Rein

12/31/2024	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000

*Recognize the excess amortization expenses for the current year

Partial Equity Method Consolidation Worksheet Entries for 2025

12/31/2025	Retained Earnings	9,500,000	
	Investment		9,500,000

*To convert parent's beginning retained earnings from partial equity method to equity method by including excess amortization

12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000

*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein

12/31/2025	Patent	16,000,000	
	Goodwill	49,500,000	
	Investment		65,500,000

*To recognize the unamortized allocations as of the beginning of the year

12/31/2025	Equity in Subsidiary Earnings	20,000,000	
	Investment		20,000,000

*To eliminate the impact of intra-entity subsidiary income

12/31/2025	Investment	7,000,000	
	Dividend		7,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2025	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000
	*To recognize the excess amortization expenses for the current year		

Initial Value Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2024	Patent	20,000,000	
	Goodwill	55,000,000	
	Investment		75,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2024	Dividend Income	4,000,000	
	Dividend		4,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2024	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000
	*Recognize the excess amortization expenses for the current year		

Initial Value Method Consolidation Worksheet Entries for 2025

12/31/2025	Retained Earnings	3,500,000	
	Investment		3,500,000
	*To convert parent's beginning retained earnings from initial value method to equity method (4,000,000 income under initial value compared to 500,000 under equity method)		
12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2025	Patent	16,000,000	
	Goodwill	49,500,000	
	Investment		65,500,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2025	Dividend Income	7,000,000	
	Dividend		7,000,000

*To eliminate the impact of intra-entity subsidiary dividends paid to Rein

12/31/2025	Amortization Expense	9,500,000	
	Patent		4,000,000
	Goodwill		5,500,000

*To recognize the excess amortization expenses for the current year

Question 4 (LO 5: Assess the value of private company GAAP vs. public company GAAP for investors and financial statement users)

The CFO of Rein, Robin Davis, has asked for your opinion about whether electing private company GAAP improves the financial information available to its financial statement users as opposed to following public company GAAP. Prepare your response, including the reasoning supporting that position, as a formal business memo addressed to the CFO of Rein.

While student responses to this question will likely vary significantly, we provide a suggested solution below, including conclusion versions that include an argument for and an argument against the use of private company GAAP:

MEMORANDUM

Date: XX/XX/XXXX
 To: Robin Davis, CFO, Rein LLC
 From: *Student Name*, Accountant, Rein LLC
 Subject: Private Company GAAP

In response to your request for my opinion about whether electing private company GAAP improves the financial information available to users, I have summarized some of the advantages and disadvantages below.

Advantages of private company GAAP

- Simplified accounting for some complex areas within accounting, including interest rate swaps, intangible assets acquired through acquisitions, tests of impairment for goodwill, and amortization of goodwill.
- Lower cost to prepare financial statements.

Disadvantages of private company GAAP

- Makes comparability of financial statements extremely complicated as companies can elect to apply some of the accounting alternatives created by the PCC and can elect not to implement others.
- If companies elect to go public at some point in the future, they will be required to use US GAAP for public companies.
- Net income numbers will be lower as a result of the amortization of goodwill; however, earnings before interest, taxes, depreciation, and amortization will generally not be affected.

A Possible Conclusion

After considering the above advantages and disadvantages, it is my opinion that private company GAAP *improves* the information provided to financial statement users when compared to public company GAAP. My opinion is based on the fact that the needs of private company financial statement users differ from those of public companies and that PCC alternatives better address those needs, including simplified accounting and reduced costs.

Another Possible Conclusion

After considering the above advantages and disadvantages, it is my opinion that private company GAAP *does not improve* the information provided to financial statement users when compared to public company GAAP. My opinion is based on the fact that complex transactions may not be presented fairly using PCC alternatives, that there is a decrease in the comparability of such financials statements, and that any benefit realized from electing PCC alternatives will be lost if the company later decides to initiate and IPO.

Case Solutions – Part 2

Question 1 (LO 1: Calculate intangible asset amounts, appropriately applying private company or public company GAAP)

Calculate the following account balances as of December 31, 2025 assuming the company has followed private company GAAP, has used the method of accounting for subsidiaries selected by your instructor for Part 1 (Equity Method, Partial Equity Method, or Initial Value Method), and has not made any adjustments for the upcoming IPO:

- a. Goodwill
- b. Patent
- c. Customer List

Goodwill

Goodwill (10-year life) from acquisition 1-1-2024	\$55,000,000
Amortization of goodwill 12-31-2024	\$(5,500,000)
Amortization of goodwill 12-31-2025	<u>\$(5,500,000)</u>
Goodwill 12-31-2025	\$44,000,000

ASU 2014-02 (ASC 350-20-35-63) allows for companies to amortize goodwill over the lesser of 10 years or the estimated useful life of the acquired goodwill.

Patent

Patent (5-year useful life) from acquisition 1-1-2024	\$20,000,000
Amortization of patent 12-31-2024	\$(4,000,000)
Amortization of patent 12-31-2025	<u>\$(4,000,000)</u>
Patent 12-31-2025	\$12,000,000

Customer List

ASU 2014-18 (ASC 805-20-25-30) allows for companies to no longer recognize separately from goodwill, customer-related intangible assets unless they are capable of being sold. As a result, the consolidated entity will not have a separate intangible asset for customer list and the amounts would be included in goodwill.

Question 2 (LO 6: Determine whether Rein will be eligible to elect private company GAAP if it decides to go through an IPO)

If Rein decides to go through an IPO, is it allowed to continue using guidance from the Private Company Council? If no, why not?

Rein would not be allowed to continue using the guidance under the Private Company Council. The FASB ASC master glossary defines private companies as “An entity other than a public business entity, a not-for-profit entity, or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.”

Question 3 (LO 2: Prepare investment journal entries, appropriately applying private company or public company GAAP)

Recreate the journal entries for Rein's investment in Lester Company as of December 31, 2024 and December 31, 2025 for Rein for the SEC prospectus as of December 31, 2025, following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.

Equity Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000
	*To record the purchase of the investment		
12/31/2024	Investment	10,000,000	
	Equity in Subsidiary Earnings		10,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2024	Cash	4,000,000	
	Investment		4,000,000
	*To record the subsidiary cash dividend		
12/31/2024	Equity in Subsidiary Earnings	5,000,000	
	Investment		5,000,000
	*To recognize amortization on allocations made in acquisition of subsidiary (Patent 4,000,000 and Customer List 1,000,000)		

Equity Method Accounting Journal Entries for 2025

12/31/2025	Investment	20,000,000	
	Equity in Subsidiary Earnings		20,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2025	Cash	7,000,000	
	Investment		7,000,000
	*To record the subsidiary cash dividend		
12/31/2025	Equity in Subsidiary Earnings	5,000,000	
	Investment		5,000,000
	*To recognize amortizations on allocations made in acquisition of subsidiary		

Partial Equity Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000
	*To record the purchase of the investment		
12/31/2024	Investment	10,000,000	
	Equity in Subsidiary Earnings		10,000,000
	*To accrue income earned by the 100% owned subsidiary		
12/31/2024	Cash	4,000,000	
	Investment		4,000,000
	*To record the subsidiary cash dividend		

Partial Equity Method Accounting Journal Entries for 2025

12/31/2025	Investment	20,000,000	
	Equity in Subsidiary Earnings		20,000,000

*To accrue income earned by the 100% owned subsidiary

12/31/2025	Cash	7,000,000	
	Investment		7,000,000

*To record the subsidiary cash dividend

Initial Value Method Accounting Journal Entries for 2024

1/1/2024	Investment	100,000,000	
	Cash		100,000,000

*To record the purchase of the investment

12/31/2024	Cash	4,000,000	
	Dividend Income		4,000,000

*To record the subsidiary cash dividend

Initial Value Method Accounting Journal Entries for 2025

12/31/2025	Cash	7,000,000	
	Dividend Income		7,000,000

*To record the subsidiary cash dividend

Question 4 (LO 3: Prepare consolidation worksheet entries, appropriately applying private company or public company GAAP)

Prepare the consolidation worksheet entries that Rein would make for Lester Company for December 31, 2024 and December 31, 2025 for the SEC prospectus, again following your instructor's guidance to use the (a) Equity Method of accounting, (b) Partial Equity Method of accounting, or (c) Initial Value Method of accounting.

Equity Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000

*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein

12/31/2024	Patent	20,000,000	
	Goodwill	40,000,000	
	Customer List	15,000,000	
	Investment		75,000,000

*To recognize the unamortized allocations as of the beginning of the year

12/31/2024	Equity in Subsidiary Earnings	5,000,000	
	Investment		5,000,000

*To eliminate the impact of intra-entity subsidiary income

12/31/2024	Investment	4,000,000	
	Dividend		4,000,000

*To eliminate the impact of intra-entity subsidiary dividends paid to Rein

12/31/2024	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000

*To recognize the excess amortization expenses for the current year

Equity Method Consolidating Worksheet Entries for 2025

12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2025	Patent	16,000,000	
	Customer List	14,000,000	
	Investment		30,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2025	Equity in Subsidiary Earnings	15,000,000	
	Investment		15,000,000
	*To eliminate the impact of intra-entity subsidiary income		
12/31/2025	Investment	7,000,000	
	Dividend		7,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2025	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000
	*To recognize the excess amortization expenses for the current year		

Partial Equity Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2024	Patent	20,000,000	
	Goodwill	40,000,000	
	Customer List	15,000,000	
	Investment		75,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2024	Equity in Subsidiary Earnings	10,000,000	
	Investment		10,000,000
	*To eliminate the impact of intra-entity subsidiary income		
12/31/2024	Investment	4,000,000	
	Dividend		4,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2024	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000
	*To recognize the excess amortization expenses for the current year		

Partial Equity Method Consolidating Worksheet Entries for 2025

12/31/2025	Retained Earnings	5,000,000	
	Investment		5,000,000
	*To convert parent's beginning retained earnings from partial equity method to equity method by including excess amortization		
12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2025	Patent	16,000,000	
	Customer List	14,000,000	
	Investment		30,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2025	Equity in Subsidiary Earnings	20,000,000	
	Investment		20,000,000
	*To eliminate the impact of intra-entity subsidiary income		
12/31/2025	Investment	7,000,000	
	Dividend		7,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2025	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000
	*To recognize the excess amortization expenses for the current year		

Initial Value Method Consolidation Worksheet Entries For 2024

12/31/2024	Common Stock	24,000,000	
	Retained Earnings	1,000,000	
	Investment		25,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein investment at Rein		
12/31/2024	Patent	20,000,000	
	Goodwill	40,000,000	
	Customer List	15,000,000	
	Investment		75,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2024	Dividend Income	4,000,000	
	Dividend		4,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2024	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000
	*To recognize the excess amortization expenses for the current year		

Initial Value Method Consolidating Worksheet Entries for 2025

12/31/2025	Investment	1,000,000	
	Retained Earnings		1,000,000
	*To convert parent's beginning retained earnings from initial value method to equity method by including excess amortization		
12/31/2025	Common Stock	24,000,000	
	Retained Earnings	7,000,000	
	Investment		31,000,000
	*To eliminate beginning equity accounts of the subsidiary and the corresponding investment at Rein		
12/31/2025	Patent	16,000,000	
	Customer List	14,000,000	
	Investment		30,000,000
	*To recognize the unamortized allocations as of the beginning of the year		
12/31/2025	Dividend Income	7,000,000	
	Dividend		7,000,000
	*To eliminate the impact of intra-entity subsidiary dividends paid to Rein		
12/31/2025	Amortization Expense	5,000,000	
	Patent		4,000,000
	Customer List		1,000,000
	*To recognize the excess amortization expenses for the current year		

Question 5 (LO 4: Compare the difference in the amount of subsidiary equity income recorded using private company GAAP vs. public company GAAP)

In the filing with the SEC, provide the calculations for the amount of equity income Rein would recognize from the Lester Company subsidiary as of December 31, **2024**. How does this differ from the amounts originally created in Part 1 of the case study?

Under public company GAAP, Rein reports \$5,000,000 in Equity in Subsidiary Earnings as opposed to only \$500,000 under the accounting alternative issued from the Private Company Council for 2024. This large increase using public company GAAP is a result of the lack of amortization for goodwill slightly offset by the amortization of the customer list.

Questions 6 and 7

The solutions to questions 6 and 7 are a continuation of the last problem in Part 1. After going through the transition from private company GAAP to public company GAAP, students may decide to change their answer based on the complexity of the calculations involved in this part of the case. During the deliberations for the Private Company Council, questions arose whether the simplifications of GAAP would reduce the usefulness of the financial statements. In addition, students will see the difference in net income and question how comparable the financial statements of private companies and public companies are and whether or not private company GAAP fairly presents the results of consolidations.

Question 6 (LO 5: Assess the value of private company GAAP vs. public company GAAP for investors and financial statement users)

In light of the changes related to the potential IPO, the CFO of Rein, Robin Davis, has once again asked for your opinion about whether electing accounting alternatives provided by the Private Company Council improves or worsens financial information and financial reporting for private companies as opposed to when private companies use public company GAAP. Prepare your response, including the reasoning for that opinion, as a formal business memo addressed to the CFO.

While student responses to this question will likely vary significantly, we provide a suggested solution below, including conclusion versions that include an argument for and an argument against the use of private company GAAP²:

MEMORANDUM

Date: XX/XX/XXXX
 To: Robin Davis, CFO, Rein LLC
 From: *Student Name*, Accountant, Rein LLC
 Subject: Private Company GAAP

In response to your request for my opinion about whether electing private company GAAP improves the financial information available to users, I have again included a summary of some of the advantages and disadvantages of using PCC alternatives.

Advantages of private company GAAP

- Simplified accounting for some complex areas within accounting, including interest rate swaps, intangible assets acquired through acquisitions, tests of impairment for goodwill, and amortization of goodwill.
- Lower cost to prepare financial statements.

Disadvantages of private company GAAP

- Makes comparability of financial statements extremely complicated as companies can elect to apply some of the accounting alternatives created by the PCC and can elect not to implement others.
- If companies elect to go public at some point in the future, they will be required to use US GAAP for public companies.
- Net income numbers will be lower as a result of the amortization of goodwill; however, earnings before interest, taxes, depreciation, and amortization will generally not be affected.

A Possible Conclusion

After considering the above advantages and disadvantages, it is still my opinion that private company GAAP *improves* the information provided to financial statement users when compared to public company GAAP. My opinion is based on the fact that the needs of private company financial statement users differ from those of public companies and that PCC alternatives better address those needs, including simplified accounting and reduced costs. Although it took significant effort to “unwind” the PCC alternatives when converting to public company GAAP, the financial statements best reflected the unique information needs of our users while a private company, and will, under public company GAAP, best reflect the needs of our users going forward as a public company. Moreover, private company GAAP better reports the results of operations while the company is actually a private company, and public accounting GAAP really only improves reporting when the company actually becomes a public company.

² On its face, this question is a moot point for public companies. However, students may recognize the need for the CFO to provide information to users, for example, to explain the change in GAAP to the Board and/or key investors. Additionally, it may help students to recognize that they may have changed their opinion from what was reflected in their first memo, given the additional consideration of the potential costs to switch from public to private company accounting.

Another Possible Conclusion

After considering the above advantages and disadvantages, it is my opinion that private company GAAP *does not improve* the information provided to financial statement users when compared to public company GAAP. My opinion is based on the fact that complex transactions may not be presented fairly using PCC alternatives and that there is a decrease in the comparability of such financials statements. These concerns are compounded when considering the significant effort to restate the financial statements to public company GAAP in order to meet the information needs of our users going forward and the significant difference in net income between public and private company GAAP, which may impact users understanding of the underlying economic position of the company and ultimately may impact their decisions.

Question 7 (LO 7: Determine whether you would choose to elect private company or public company GAAP for a private company)

When commencing a private company would you choose to elect one or more Private Company Council accounting alternatives? Identify some of the circumstances, if any, when you would be (a) likely and (b) unlikely to elect private company GAAP. Prepare your response, including the reasoning for your response, as a formal business memo addressed to your instructor.

While student responses to these questions will likely vary significantly, we provide a suggested solution below:

MEMORANDUM

Date: XX/XX/XXXX
 To: *Instructor Name*
 From: *Student Name*
 Subject: Private Company GAAP

In response to your request for my opinion about whether I would elect PCC accounting alternatives when commencing a private company, I have determined that my answer depends on several things. I have summarized below some of the circumstances when I believe I would be likely to elect private company GAAP as well as some of the circumstances when I believe I would be unlikely to elect private company GAAP.

Likely to adopt private company GAAP

I would be more likely to adopt PCC accounting alternatives under the following circumstances:

- When the probability of a future IPO is low, is far in the future, or both.
- When comparability is less important for my financial statement users.
- When I do not believe any reduction in net income, for example, from amortizing goodwill, would negatively impact the decisions of the financial statement users.
- When cost savings and/or timeliness of financial information are of upmost importance.

Unlikely to adopt private company GAAP

I would be unlikely to adopt PCC accounting alternatives under the following circumstances:

- When the probability of an IPO in the near future is high, or even when the long-term goal of the company is to initiate an IPO in the future. The effort involved in converting the financial statement amounts from private company GAAP to public company GAAP in this case made me realize the potential costs and complexities involved in completing such a conversion. As a result, I have concluded that any benefit from PCC accounting alternatives is likely to be outweighed by the potential cost of converting from private to public company GAAP for a company with an IPO plan or goal.
- When comparability is important to financial statement users, when evaluating private and public companies.

- When I believe that a reduction in net income from adopting such alternatives, such as the amortization of goodwill, would negatively impact the decision of the financial statement users.

Conclusion

There are both potential advantages and disadvantages to electing PCC accounting alternatives. The answer to whether I would elect such alternatives if commencing a private company depends on the unique combination of the individual circumstances, and no one conclusion can be reached. The answer depends on the uniqueness of the business, its stakeholders and its desires to become a public company.

Student Perceptions

This case was used in two advanced accounting courses using the full equity method. In addition, this case was used in part at a second university, and feedback was received from the instructor using a portion of the case. Students were instructed how to log into the Accounting Standards Codification and were a part of a discussion around intangible assets. As the instructor did not assign the full case, detailed student perceptions about the entire case are not available from that instructor. Students receiving the full case, nevertheless, were asked eight questions on whether they believe the case enhanced their understanding of consolidations and the impact the PCC accounting alternatives have on the financial statements. Table 1 provides the results of those student responses.

Results from the student perceptions show students strongly believed the case was useful, improved their critical thinking and problem-solving skills, and helped expand their understanding of the various options available for private companies to explore. Moreover, even while providing the GAAP references, students believed the case improved their research skills and ability to apply and interpret authoritative literature. The comprehensiveness of the case, the introduction of the PCC guidelines, the restatements required when transitioning to public accounting GAAP, and the thought process mandated by students in comparing the usefulness of PCC versus public accounting GAAP make this case comprehensive, extensive and an extension of end of chapter problems provided by textbook authors.

Additionally, we administered a survey prior to assignment in one semester and noted that student responses indicated they were not familiar with PCC alternatives. Specifically, 81% of 21 respondents indicated they somewhat or strongly disagree with the statement "I am familiar with the Private Company Council accounting alternatives that private companies can choose to elect" (from the choices "Strongly agree," "Somewhat agree," "Neither agree nor disagree," "Somewhat disagree," and "Strongly disagree"), and all students except one were unable to respond to "From your current knowledge, if you are able, what are some of the Private Company Council accounting alternatives that private companies can choose to elect?" (instead, they left the question blank, responded with "N/A," or said they didn't know - e.g., "I don't know," "no clue," "?," "unaware," etc.).

Conclusion

This case provides students an opportunity to explore an area of accounting not frequently fully covered in many curricula, while reinforcing the concepts around consolidations generally covered earlier in the semester.

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Table 1 – Student Perceptions (N = 66)	
Question	Mean (Standard Deviations)
1. Overall usefulness of the case.	4.45*
	(0.77)
2. I would recommend that this case be used as a part of this course in the future.	4.21*
	(0.92)
3. The case analysis exercise was beneficial to enhancing teamwork skills.	4.35*
	(0.89)
4. The case improved my ability to identify, interpret, and apply the U.S. authoritative accounting literature using FASB codification and other sources.	4.60*
	(0.72)
5. The case enhanced my ability to search the literature to identify prevalent accounting practice on a given issue.	4.62*
	(0.74)
6. The case assignment requires critical thinking and problem-solving skills.	4.70*
	(0.58)
7. The case enhanced my understanding of the issues facing private companies.	4.53*
	(0.77)
8. The case enhanced my understanding of the different approaches under US GAAP and the implications to choosing each.	4.55*
	(0.77)

Five-point Likert-type scale ranging from 1 as strongly disagree to neither agree nor disagree to 5 as strongly agree.