

## Private Company Financial Reporting Committee

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JUDITH H. O'DELL  
Chair

### Meeting Highlights December 3-4, 2009

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Norwalk, Connecticut

All Private Company Financial Reporting Committee (“PCFRC” or “Committee”) members were in attendance, except Maryann Lawrence.

*Financial Accounting Standards Board (“FASB”) Staff:* Paul Glotzer  
*American Institute of Certified Public Accountants (“AICPA”) Staff:* Bob Durak and Dan Noll

#### **December 3<sup>rd</sup> Meeting with the Small Business Advisory Committee (“SBAC”) and the FASB**

On December 3<sup>rd</sup>, the PCFRC met jointly with the SBAC and FASB. The following matters were discussed:

- *Report of the FASB chairman, Bob Herz.*
  - Initial information about a potential FASB project on multiemployer pension plans was provided by the FASB chairman.
  - Mr. Herz also provided an update about the important Financial Statement Presentation project. The FASB is currently re-deliberating the proposals in the project and an Exposure Draft is expected to be issued in April 2010 or thereabouts.
    - In the coming months, FASB staff will address how the Financial Statement Presentation project will or will not apply to private companies.
    - Tentatively, the FASB has decided to require a direct method of reporting cash flows but with less detail than initially proposed in the Discussion Paper. Mr. Herz recognized that a direct method cash flow statement would be more costly to prepare and requiring less detail should alleviate some of the cost burden.
    - The FASB tentatively decided to replace the proposed reconciliation schedule with an analysis of the changes in balances of all significant asset and liability line items. The analysis will explain the nature of the transactions and other events that gave rise to a change in the account balance.
    - For the statement of comprehensive income (“SCI”), the FASB tentatively decided to retain the proposal that an entity should disaggregate income and expense items by function and by nature. Further, the FASB tentatively decided that an entity that has only one reportable segment should present that disaggregated

information on the face of the SCI and that an entity that has more than one reportable segment should present that disaggregated information in its segment note.

- The FASB tentatively decided to have reporting entities present information about remeasurements in the financial statements. The FASB tentatively agreed to require disaggregation of remeasurements on the face of the SCI in a columnar format.
  - The FASB chairman reported that ASU 2009-06, *Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*, was issued by the FASB and that a number of EITF issues have recently been ratified by the FASB, including Issue No. 08-1, "Revenue Arrangements with Multiple Deliverables (Accounting Standards Update No. 2009-13—Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements).
  - The FASB and the International Accounting Standards Board ("IASB") agreed to redouble their convergence efforts and hold monthly meetings to make quicker progress on their key projects.
  - Recently proposed legislation that would hand over responsibility for overseeing accounting standards to the agencies being contemplated to oversee systemic risk, effectively removing the SEC as the primary overseer of FASB, was scaled back.
- *Report of the Securities and Exchange Commission ("SEC").* Jenifer Minke-Girard provided an overview of recent SEC activities that may be of interest to the members of the SBAC.
  - *Report of the Public Company Accounting Oversight Board ("PCAOB").* Greg Fletcher provided an overview of recent PCAOB activities that may be of interest to the members of the SBAC.
  - *Report of the PCFRC.* Judy O'Dell, chair of the PCFRC, provided a review of recent PCFRC activities, including highlights from PCFRC meetings, recommendation and comment letters issued, and progress made on various projects.
  - *Future Financial Reporting for Nonpublic Entities and the FASB's Disclosure Framework project*

The objective of this part of the joint meeting with the SBAC and the FASB was to provide views on the future financial reporting for nonpublic entities, including various alternatives and benefits and concerns. Another objective was to discuss the proposed scope and approach on the FASB's Disclosure Framework project.

Judy O'Dell began the discussion with a summary of the PCFRC's November 2, 2009 letter to the Financial Accounting Foundation ("FAF") about accounting standards for private companies. The letter contained the following key points:

- FAF needs to consider the issue of U.S. private company accounting in the context of the mission of the FASB.
- The Committee believes that a separate, stand-alone set of accounting standards for U.S. private companies tailored to the needs of the users of those statements is the preferred approach.
- The Committee realizes there could be other major alternatives for private company accounting that should be explored.

Ms. O'Dell pointed out recent events and trends affecting private company accounting, including:

- The issuance of the International Financial Reporting Standard for Small- and Medium-Sized Entities (“IFRS for SMEs”).
- Efforts underway in other countries addressing private company GAAP (such as in Canada, Australia, the U.K., and South Africa).
- Recent surveys of financial professionals in the U.S. that demonstrate a preference for differential accounting standards for private companies.
- The increasing number of complicated accounting standards, driven primarily by public company investor and analyst needs, which are often expensive to implement for private companies and provide no real benefit for the users of private company financial reporting.

Then, Ms. O'Dell and other PCFRC members talked about private company financial statement user needs and cost/benefit issues, making the following points:

- Private company financial statements in many ways are intended to satisfy different informational needs than public company financial statements.
- Users need a basic set of GAAP financial statements in a prescribed format.
  - Constant changes and high complexity hinder usefulness.
  - Middle ground between non-GAAP OCBOA-type financial statements and overly complex and voluminous financial statements is needed.
  - Users want GAAP and do need certain notes (e.g., accounting policies, schedule of debt/obligations, contingent liabilities, transactions with owners.)

Ms. O'Dell concluded her opening remarks by stressing the importance of the FAF acting now to address private company accounting, in light of the forces already at work shaping the future of private company financial reporting in the U.S.

Afterwards a robust discussion ensued among members of the PCFRC, the SBAC, and the FASB about private company accounting. The following key points were made:

- An SBAC member commented that a separate body should be formed to develop a financial reporting and accounting framework for private companies. Such a committee would also develop a structure and funding mechanism for a separate private company accounting standards board, allowing the FASB to deal solely with public company accounting.
- Contrary to the prior comment, another SBAC member stated that creating a separate board to set private company standards is unwarranted. While separate standards are needed for private companies, the FASB should set those standards.
- Other SBAC members believed that maintaining two sets of accounting standards (one for public companies and one for private companies) would be

disruptive to the economy and present educational challenges to the profession. A better solution would be to maintain one set of GAAP and establish an effective way of reducing the burden on private company constituents.

- The FASB chairman was of the opinion that the demands of the marketplace should be met and yet he is skeptical of a separate set of private company standards, believing it makes sense to maintain an integrated accounting and financial reporting system for public and private companies. That system could include differences in standards for private companies, including perhaps recognition and measurement differences. If public companies were to eventually adopt IFRS, then maybe IFRS for SMEs might make sense for U.S. private company use. If public companies were to stay with U.S. GAAP as it evolves through convergence with IFRS, then U.S. private companies should follow accounting standards that are vertically integrated but meets cost/benefit tests of private company constituents.
- Another FASB member was open to establishing differences in disclosure requirements for private companies but found it difficult to entertain different recognition and measurement standards for private companies.
- Some PCFRC members restated the recommendations in the recent PCFRC letter to the FAF that private company accounting needs to be addressed now and that a separate set of stand-alone accounting standards for private companies is preferred. Furthermore, a stand-alone standard setting process for private companies, divorced from the politics surrounding public companies, would be beneficial.
- One PCFRC member pointed out that currently U.S. private companies can account for the same transaction differently under U.S. GAAP or IFRS for SMEs and yet both treatments would be considered GAAP in the U.S.. The PCFRC member believes that the Memorandum of Understanding between the FASB and the IASB needs to reconcile this issue.
- Teresa Polley, president of the FAF, interjected that the FAF trustees are aware of the serious concerns of private company constituents and during the FAF's recent listening tour often heard that a solution was needed to solve the private company accounting issue. The FAF believes the private company accounting issue is worth taking a fresh look at and is currently having discussions about the best course of action.
- An SBAC member commented that while the FASB's Disclosure Framework project may make sense for public companies, it does not make sense for private companies. The additional disclosures would be burdensome to private companies while offering little or no benefit to private company financial reporting users.

#### **December 4<sup>th</sup> Meeting with the FASB**

On December 4th, the PCFRC met with the FASB. Highlights of that discussion follow:

- *Evaluation of the PCFRC's activities.* Reviewing the Committee's work since it last met with the FASB, the PCFRC solicited input from the FASB on the Committee's activities, processes, letters, and meeting minutes. The FASB was of the opinion that the Committee's letters and meeting minutes contained

- sufficient detailed information and its processes and approach to its work were sound. The FASB emphasized their appreciation of the PCFRC's work and their attentiveness to the recommendations and comments of the Committee. The FASB will strengthen its efforts to gain PCFRC input in the early stages of standards projects. Also, the FASB and the PCFRC both expressed a belief that face-to-face meetings between the two bodies have proven valuable and should continue.
- Private company financial statement users. The difficulty of getting private company financial statement users actively engaged in the Committee's work was discussed. To increase user involvement, the following actions will be taken:
    - James Stevenson will reach out to the National Venture Capital Association ("NVCA") staff and attempt to identify NVCA board members who could be resources to the Committee.
    - Judy O'Dell will continue to contact private company financial statement users and ask them to join the PCFRC User Panel.
    - FASB members suggested utilizing private company financial statement users to provide input on specific projects, as circumstances warrant. FASB staff could lay out the issues of a particular project in a phone call with users identified by the PCFRC.
    - The PCFRC will look to provide private company financial statement users to the FASB to help field-test certain standards projects.
  - Improvements to ASUs. The PCFRC asked the FASB to improve the wording and structure of the FASB's Accounting Standards Updates ("ASU"). For example, a substantial explanatory section at the front of an ASU would be helpful. Also, including the whole text of the subtopic in the ASU instead of just the part of the subtopic that is being modified may provide better context and clarity. The FASB agreed that improvements to the ASUs are needed and intends to identify and implement them in the near future. One idea being considered by the FASB is to explain the accounting standard requirements and changes in plain English and locate Basis for Conclusions sections next to the new requirements and changes.
  - Financial Instruments with Characteristics of Equity project. James Stevenson of the PCFRC explained the PCFRC's concerns related to the FASB's project on Financial Instruments with Characteristics of Equity. In particular, James emphasized the following points:
    - The users on the PCFRC believe that whether cash or shares are used to settle an instrument is *very significant*.
      - A requirement to settle an instrument using cash or other assets of an enterprise is very relevant to lenders, suppliers and other grantors of credit since the resources used would not then be available to satisfy the claims of other creditors.
      - The issuance of shares of common stock or other equity instruments does not consume resources of the enterprise that would otherwise be available to satisfy the claims of creditors.
    - For private companies, equity securities issued are not easily convertible to cash.

- The most common form of investment in private companies by venture capital firms is convertible preferred stock.
  - The preferred shares held by the venture capital firms provides a priority return over common shareholders, but does not represent a claim against the cash or assets of the enterprise.
  - These preferred shares are convertible into common shares at the option of the holder, but are generally held until the private company is sold, liquidated or goes public.
  - Convertible preferred stock should be classified as equity.
- Fair value accounting. PCFRC members shared their thoughts with the FASB on the applicability of fair value accounting in the private company sector. The following points were made:
  - With some exceptions (possibly alternative investments), fair value measurements are not as relevant to private companies as they are for public companies.
  - Private company financial statement users base their decisions on cash flow information and, generally, have already discounted other noncash and intangible gains/losses.
  - GAAP requires private companies to spend money on goodwill impairment evaluations. However private company financial statement users generally disregard goodwill and other intangible assets in their analyses. A “trigger” approach to goodwill impairment would be an improvement.
  - Private companies incur significant costs in reporting fair value information for financial instruments other than those that are traded in an active market. These costs occur in obtaining prices and rates, calculating fair values and in additional costs of attestation.
  - The amortized cost of a debt instrument provides more relevant information than its fair value when analyzing the financial statements of a private enterprise.
- Volume of FASB’s documents being issued in early 2010. The PCFRC expressed concern to the FASB about the large volume of exposure drafts and final standards expected to be issued during the first half of 2010 (The PCFRC estimates that eight exposure drafts, one discussion paper, and three final standards are planned to be issued in the first six months of 2010.) The FASB stated that they intend to provide two to three month comment periods on the exposure drafts and discussion paper.

### **Accounting for Financial Instruments**

The PCFRC reviewed the current direction of the FASB’s project on financial instruments. Tentatively, the FASB has decided that an entity should recognize all of its financial instruments in its statement of financial position as either financial assets or financial liabilities depending on the entity’s present rights or obligations in the contracts. It is the FASB’s tentative decision to use fair value as the only measurement basis for all financial instruments (including loans), except for own debt if certain criteria are met.

PCFRC members believe that items such as accounts receivable, own debt, and accounts payable should not be measured at fair value in the private company sector. Financial statement users would not find such information useful. The PCFRC will communicate its concerns to the FASB and its staff.

### **Disclosure Framework Project**

The objectives of the FASB's Disclosure Framework project are to (1) establish an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant, and (2) seek ways to better integrate information provided in financial statements, MD&A, and other parts of a company's public reporting package. The PCFRC believes this project is important to private company financial reporting constituents and the PCFRC intends to provide the FASB with its viewpoints and recommendations as the project progresses. The PCFRC hopes that this project will provide an opportunity to achieve a simplification of the current GAAP disclosure requirements for private companies.

In discussing the project, the PCFRC concluded that the proposed disclosure framework should apply to all companies, both public and private, for general purpose financial reporting. Concerned about disclosure overload, the PCFRC believes that a minimum base or threshold that broadly applies should be developed with potential add-ons to address the incremental information needs for public companies. In addition, Committee members were of the opinion that roll-forwards of significant balance sheet line items were not very valuable to private company financial statement users and as such not worth the cost of preparing such roll-forwards. Users believe that the information provided by roll-forwards can be obtained from management and the statement of cash flows.

Private company financial reporting users value a number of disclosures, including information about accounting policies, concentrations of credit, future obligations and debt maturities, lease obligations, related parties, and contingent liabilities, among others. On the other hand, certain disclosures are not very valuable to those users, such as those about goodwill, share-based compensation, post-retirement obligations, and fair value.

The PCFRC's task force on this project will continue to monitor its progress.

### **Financial Instruments with Characteristics of Equity**

The PCFRC discussed recent developments related to the FASB's project on Financial Instruments with Characteristics of Equity. The latest approach being considered by the FASB seems to alleviate the original concerns of the PCFRC about this project. Under the latest approach, a company would classify as equity particular share-settled instruments. A company would classify as equity an instrument it must settle by issuing equity instruments unless the issuer is using the equity instruments as currency. James Stevenson will work with others in the venture capital industry to develop examples of common venture capital investments and the potential impact of this project on those investments. That information will be shared with the PCFRC, which will then consider

the need to communicate those examples and any recommendations to the FASB on this project. In addition, James will consider forming a roundtable of venture capital professionals to meet with the FASB on this project.

### **Financial Statement Presentation**

The PCFRC discussed the results of recent FASB-IASB field-testing of the proposals in the Financial Statement Presentation Discussion Paper. Participants in the field tests recast their financial statements under the proposed financial statement model. Most participants in the field tests thought that the recast statements did not do a better job than the non-recast statements in communicating the results of core operations. That data seems to reinforce the PCFRC's contention that the proposals in the project would not be beneficial to private company constituents and yet impose a significant cost burden upon them. The PCFRC and the FASB agreed that the PCFRC should work closely with FASB staff in early 2010 as the FASB staff addresses the applicability of the project to private companies.

### **Revenue Recognition**

Progress on the FASB's Revenue Recognition project was reviewed by the PCFRC. In particular the Committee reviewed the FASB's tentative decisions on allocating the transaction price of a contract. Among other items, the FASB decided tentatively that:

1. An entity should allocate the transaction price to segments of a contract rather than to individual performance obligations.
2. When segmenting a contract, an entity should consider when the promised goods and services are transferred to the customer, the margins for those goods and services, and materiality.
3. An entity should estimate standalone selling prices if they are not observable.

The FASB also tentatively decided that when goods and services in a contract segment are transferred at different times (or continuously), an entity must determine how much revenue to recognize as each performance obligation is satisfied. The FASB decided tentatively that:

1. An entity should select a method of measuring performance that best depicts the transfer of goods and services to the customer. Acceptable methods include methods based on units of output, units of input, or the passage of time.
2. An entity should select one method per segment and apply that method consistently throughout the contract and across segments with similar characteristics in other contracts.

The PCFRC will continue to monitor this project.

### **Lease Accounting**

Progress on the FASB's Leases project was reviewed by the PCFRC. The FASB has made some recent tentative decisions about initial and subsequent measurement of the lessee's obligation to pay rentals and right-of-use asset and about leases with options. In addition the FASB has been addressing the lessor side of lease accounting and has made

tentative decisions about initial and subsequent measurement of the lessor's receivable and performance obligation and about leases with options. For information about those decisions, see the FASB web site at

[http://www.fasb.org/cs/ContentServer?c=FASBContent\\_C&pagename=FASB%2FFASBContent\\_C%2FProjectUpdatePage&cid=900000011123](http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=900000011123)

### **FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R)**

The FASB project manager responsible for FASB Statement No. 167 and FIN 46(R) met with the PCFRC to hear the concerns of the Committee on accounting for variable interest entities in the private company sector. A discussion about the applicability of FIN 46R/FASB 167 to common arrangements found in the private company sphere took place. Also, the PCFRC discussed how the current lease accounting project might affect the accounting and reporting for those arrangements.

### **Educational Session on Private Company Financial Reporting User Needs**

The PCFRC participated in a joint educational session with the SBAC and FASB to hear PCFRC user members talk about their financial reporting informational needs. Some key points made by the financial statement users were:

- GAAP financial statements are important in their decision making, as GAAP provides a common language among companies.
- The character and integrity of management is key and a primary consideration.
- Surety users do not enjoy the same day-to-day relationship with a client company like lenders and venture capitalists do.
- Reducing the cost of complying with accounting standards is important.
- Intangible assets and information about them are usually not valuable.
- Fair value measurements and information about fair value is of questionable worth. Level 3 fair-values, given their inherent subjectivity and uncertainty, are often dismissed by private company financial statement users. As such, additional disclosure about those level 3 fair values is generally not useful.
- Financial reporting needs sometimes differ between lenders, sureties, and venture capitalists.

### **Administrative Matters/Next PCFRC Meetings**

Three PCFRC members, Charlie Bramley, Daryl Buck, and Jerry Murphy, are rotating off the Committee after three years of service. The PCFRC is thankful to all three members for their contributions to the Committee. From his perspective as a seasoned audit partner, Charlie brought practical, to-the-point knowledge about private company financial reporting to the PCFRC's discussions. His work and insights on the application of FIN 46R in the private company sector were particularly valuable. The Committee benefited greatly from Daryl's experience as a hands-on CFO. His deep-rooted comprehension of financial reporting and his leadership on many issues, especially the leasing project, contributed greatly to the PCFRC's success. Jerry's sensible, real-world advice on how existing and proposed accounting standards would impact private companies and his ability to pithily share his knowledge in a manner that everyone could quickly grasp played a key part in the Committee's achievements. The PCFRC wishes

Charlie, Daryl, and Jerry well and hopes they will continue to be resources to and friends of the Committee.

The PCFRC will be seeking two preparers of private company financial statements and one CPA practitioner to fill vacancies on the committee.

The PCFRC formed a task force to work on the FASB's Accounting for Financial Instruments project. James Stevenson will lead the task force, also comprised of Chris Rogers and John Burzenski. Steve Shelton will take over leadership of the Leasing task force and Chris Rogers will lead the Revenue Recognition task force.

Tentative PCFRC meeting dates for 2010 are as follows:

- April 29-30, 2010 (Orlando, Florida)
- June 24-25, 2010 (Norwalk, Connecticut)
- September 9-10, 2010 (TBD)
- December 2-3, 2010 (Norwalk, Connecticut)

A private conference call is tentatively scheduled for February 4, 2010.