Private Company Financial Reporting Committee

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JUDITH H. O'DELL
Chair

Meeting Highlights June 28-29, 2012

Norwalk, Connecticut

In Attendance:
Private Company Financial Reporting Committee ("PCFRC" or "Committee"): Judy O'Dell (chair), Steve Bodine, Steve Shelton, John Burzenski, Tom Groskopf, Mary Ann Lawrence, James Stevenson, Jim Smith, David Lomax and George Beckwith

Financial Accounting Standards Board ("FASB") member Russ Golden, FASB assistant director Jeff Mechanick

American Institute of Certified Public Accountants ("AICPA") staff members, Dan Noll and Bob Durak

Other FASB staff members participated in parts of the meeting as needed for project updates and discussions.

Note that all discussions of FASB projects reflect the project's status as of the date of this meeting. Check the FASB website for further updates.

Non-public Entity Fair Value Measurement Disclosures

Leslie Seidman (FASB Chair) announced that this project has been removed from the FASB's current technical. In consultation with other FASB members, the Chair decided to drop the project based on input received from various stakeholders, including the PCFRC and the FASB's Small Business Advisory Committee indicating that the benefits of the proposal to modify certain disclosure requirements for private companies would be very limited, compared with the benefits that the FASB originally expected. Additionally, many stakeholders suggested that the Board first consider the accounting for certain fair value measurements for private companies before addressing fair value disclosures; however, that approach would be beyond the limited scope of this disclosure project. Ms. Seidman also announced the FASB's intent to share the work performed during this project, including the input obtained from private company stakeholders, with the Private Company Council ("PCC"), once it is seated, to inform the PCC about private company considerations related to Level 3 fair value measurement accounting and disclosure requirements.

Consolidations – Principal vs. Agent

FASB staff provided an update about this project to the PCFRC. The Committee issued a comment letter about this project on January 25, 2012. Overall the Committee believes that the Proposed ASU will be an improvement to the consolidation literature (especially general/limited partnership considerations) by adding the principal versus agent analysis. PCFRC members stated that significant disparity in practice still exists among preparers and practitioners in identifying VIEs and determining whether a reporting entity is the primary beneficiary. This disparity has created concerns among users of financial statements. Implementation guidance needs to be improved. Real life private company examples such as those discussed with the Board at the PCFRC's November meeting are needed. PCFRC members were of the opinion that such implementation guidance needs to be issued as soon as possible and should not be delayed until the Leases and Consolidation projects are completed. Also, the PCFRC believed that such implementation guidance should be included in the FASB Accounting Standards Codification.

PCFRC members also discussed the impact of the Proposed ASU on the accounting by partnerships involved with low-income housing tax credit entities. Different accounting treatments can result depending upon whether the entity is a for-profit or nonprofit entity even when the circumstances are the same. Finally, the Committee discussed with FASB members and staff the inter-relatedness of VIE accounting and related party lease accounting.

Liquidity and Interest Rate Risk Disclosures

The Committee discussed the recently issued Proposed ASU on liquidity and interest rate risk disclosures. The Proposed ASU is intended to improve financial reporting about certain risks inherent in financial instruments and how they contribute to the reporting organization's broader risks. The comment deadline is September 25, 2012.

Committee members expressed preliminary thinking that the proposed disclosures are generally not needed by users of non-financial institution private company financial statements. No problem currently exists in this area of reporting for these private companies and requiring the proposed disclosures would add cost to private companies without a commensurate reporting benefit to financial statement users. Committee members were of the tentative opinion that the proposed disclosures are too extensive in their scope and volume. In addition, Committee members made the following points:

- When a private company is having a liquidity problem, the financial statement users normally are aware of it long before the financial statements would disclose the problem.

- Perhaps some limitations or triggering mechanism can be introduced that would require the proposed disclosures be made only for those entities which truly need to report them.

- In the private company environment, for situations in which an entity's liquidity is provided by its owners, the owners would be extremely reluctant to provide some of the proposed disclosures and commit to providing future liquidity.

- Liquidity disclosures are often time-sensitive. By the date users receive a private company's financial statements those liquidity disclosures may be outdated and no longer relevant.

Financial Instruments

FASB staff provided an update to the PCFRC about the classification/measurement, impairment, and hedging components of the financial instruments project. The FASB intends to re-expose the proposed guidance in the 4th quarter of 2012 for public comment. The PCFRC has not, at this point, identified any major preliminary concerns with the proposed guidance. Generally, the proposed guidance would be more of a concern to financial institutions.

The Committee suggested that examples currently contained in the Subsequent Events section of the FASB Codification (FASB ASC section 855) should be considered for conforming changes to reflect the new proposed financial instruments guidance concerning expected loss allowances. In addition the Committee suggested that if and when the proposed guidance is finalized, private companies will need to be made aware of the changes related to providing an expected loss allowance for trade receivables under the proposed model.

Presentation of Comprehensive Income

The PCFRC was provided with an update about this project by the FASB staff. The FASB decided that the presentation requirements deferred in Accounting Standards Update 2011-12 would not be reinstated due to the excessive costs to preparers and the potential cluttering effect on the statement(s) where comprehensive income is reported. These requirements would have required an entity to present on the face of the financial statement where net income is presented the effect of items reclassified from accumulated other comprehensive income on the line items of net income. As an alternative, the Board decided that user's needs for information about items reclassified from accumulated other comprehensive income and their corresponding impact on net income could be aided, with little cost to preparers, by requiring an entity to provide enhanced disclosures to explain the effect of reclassification adjustments on other comprehensive income by component. In addition, an entity would be required to provide a tabular disclosure showing the effect of items reclassified from accumulated other comprehensive income on the line items of net income with references to other disclosures required under U.S. GAAP.

Leases

FASB staff informed the PCFRC about the two approaches currently being considered by the FASB and IASB to recognize lease expense by the lessee. A lessee would follow one approach or the other depending upon how much of the underlying asset in the lease is being consumed by the lessee. The lessor would follow an accounting model similar to the lessee model. The FASB expects to re-expose the proposed leases guidance in the 4th quarter of 2012 for public comment.

The PCFRC discussed related party leases with FASB staff and scheduled a conference call (subsequently held on July 24) to provide the FASB staff with more detailed information about related party leases issues. The PCFRC has identified unwritten and month to month leases as common practice among related parties. In addition, the Committee discussed the possibility of allowing a lessee to use a zero discount or the applicable federal rate when a lessee has no debt and would not have an incremental borrowing rate to refer to. Finally, the PCFRC expressed its concerns about the need for clear language in the proposed guidance concerning the substitutability of leased assets. PCFRC members are concerned that if the guidance is not clear, some private companies may use "substitutability" as a way to avoid lease accounting.

Investment Property Entities

FASB staff informed the Committee about recent progress in the investment property entities project. The FASB will re-deliberate the proposed guidance and expects to issue a final standard in the 4th quarter of 2012.

Disclosure Framework

The FASB's project to improve the effectiveness of financial statement disclosures was reviewed by the PCFRC. An Invitation to Comment on this project was subsequently issued by the FASB on July 12. The PCFRC will review the ITC and provide input to the FASB, as necessary.

Liquidation Basis of Accounting and Going Concern

The PCFRC considered FASB's project to issue guidance to clarify when an entity should apply the liquidation basis of accounting and to provide principles for the measurement of assets and liabilities under the liquidation basis of accounting as well as any required disclosures. Subsequent to the PCFRC's meeting, the FASB issued a Proposed Accounting Standards Update on July 2 about the liquidation basis of accounting. The Committee will review the proposed requirements and provide input to the FASB as necessary.

Private Company Accounting Decision Making Framework/Definition of a Nonpublic Entity

FASB staff updated the Committee about the project to develop a framework for use by the FASB and the new Private Company Council in making decisions about whether and when to adjust the requirements for recognition, measurement, presentation, disclosure, effective dates, and transition methods for financial accounting standards that apply to private companies. The PCFRC complimented the staff who worked on this project. The PCFRC made the following points:

- Some Committee members suggested that the FASB reconsider a potential requirement in the Framework for a private company to make an irrevocable decision to avail itself of all of the recognition and measurement private company differences in GAAP or none of them.

- Concerns were expressed about ensuring that the Framework, once finished, is given an appropriately permanent and significant place in the standard-setting process.

As part of the discussion about the framework, the PCFRC and FASB staff discussed the FASB's separate but concurrent project to define a nonpublic entity. Some PCFRC members suggested that the FASB take a more flexible approach to the definition rather than a pass/fail method. Under the suggested approach, there would be a base definition of a nonpublic entity and different gradients of companies as one moved towards having the characteristics of a public entity.

Subsequent to the PCFRC meeting, the FASB issued an Invitation to Comment on the proposed framework on July 31. The FASB's tentative conclusions about the definition of a nonpublic entity are included as appendix B to the ITC. The comment deadline is October 31. The PCFRC will develop comment points at its October 4-5 meeting.

Revenue Recognition

The latest revenue recognition project developments were reviewed by the Committee and FASB staff. The FASB and IASB continue to re-deliberate the project and expect to issue a final standard in early 2013.

Joint Meeting between the PCFRC and the FASB

In a closed session, Leslie Seidman (FASB Chair) talked to the PCFRC about the newly established Private Company Council. After the closed session, the PCFRC discussed the following projects with the FASB. See the meeting highlights above for a description of the points and concerns expressed by the PCFRC related to these projects.

- Nonpublic entity fair value measurement disclosures
- Decision-making framework for private companies
- Liquidity and interest rate risk disclosures
- Going concern
- Leases
- Consolidation—principal vs. agent and VIEs
- Financial instruments: impairment

Next PCFRC Meeting

The Committee set October 4-5, 2012 as its next meeting date.