

## **MINUTES OF THE DECEMBER 13, 2016 PRIVATE COMPANY COUNCIL MEETING**

Location: FASB Offices  
401 Merritt 7  
Norwalk, Connecticut

Tuesday, December 13, 2016

Starting Time: 8:30 a.m.

Concluding Time: 12:30 p.m.

### **PCC Members Present:**

Candace Wright (Chair)  
Steven Brown  
Jeffery Bryan  
Timothy Curt  
Thomas Groskopf  
David Lomax  
Carleton Olmanson  
Larry Weinstock  
Beth van Bladel (Incoming 2017)  
Richard Reisig (Incoming 2017)  
Yan Zhang (Incoming 2017)

### **PCC Members Absent:**

George Beckwith (Participated remotely)  
David Hirsch (Incoming 2017)

### **FASB Board Members Present:**

Russell Golden (Chairman)  
James Kroeker (Vice-Chair)  
Christine Botosan  
Daryl Buck  
Harold Monk (Incoming 2017)  
Hal Schroeder  
Marc Siegel

### **FASB Board Members Absent:**

Larry Smith

### **FASB Staff Present:**

Susan Cospers	*Matt Esposito	*Andrew Thornburg
Jeffrey Mechanick	*Aarika Friend	*Julie Um
Michael Cheng	*Jeff Gabello	*Cullen Walsh
Benjamin Dart	*Adam Kamhi	*Danielle Zeyher
Brian McKeown	*Shayne Kuhaneck	

\*For certain issues only.

## INTRODUCTORY REMARKS

Private Company Council (PCC) Chair Candy Wright opened the discussion by thanking the outgoing PCC members for their service: Tom Groskopf, Harold Monk, Carleton Olmanson, and George Beckwith. The PCC Chair also thanked Daryl Buck, outgoing FASB member, and Ben Dart, outgoing Postgraduate Technical Assistant. The PCC Chair then welcomed the incoming PCC members: Beth van Bladel, Richard Reisig, David Hirsch, and Yan Zhang.

## DISCUSSION OF AGENDA TOPICS

### Accounting for Financial Instruments - Hedging

The FASB staff provided background on the accounting for hedging activities and reported on the feedback received on the FASB's proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, issued in September 2016. The staff discussed issues relevant to private companies, including the PCC alternative (Update No. 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach*) that allows private companies to apply a simplified hedge accounting approach to plain vanilla interest rate swaps. The FASB staff also mentioned the question included in the proposed Update regarding whether hedging documentation for private companies should be different. The staff solicited feedback regarding the proposed simplifications to hedging documentation and asked whether the PCC believes that additional relief should be provided.

The PCC Chair opened the discussion by stating that the simplification of the critical terms match method and the removal of separate accounting for the ineffective portion of the hedge are both positive improvements set forth in the proposed Update. Several PCC members stated that the proposed amendments are a great simplification initiative and the objective of aligning the accounting and risk management strategies of companies will be beneficial to both public and private companies.

Several PCC members acknowledged that the hedging guidance is difficult to navigate and that some private companies choose not to apply hedge accounting guidance due to its complexity and the complexity of the documentation. A PCC member commented that he thinks the proposed Update will help in that regard, but he is uncertain whether reorganizing or rewriting the guidance or providing additional education would be helpful for private companies without also requiring documentation only on an annual basis. That PCC member further explained that the proposed quarterly assessment for most private companies does not provide relief since most private companies only provide annual financial statements.

Several PCC members commented that they think it would be beneficial for private companies to be able to look back periodically over the course of the annual reporting period to see whether the hedge was highly effective, rather than only at the end of the proposed 90-day period. PCC members commented that private companies should be given additional latitude since the 90-day period is not significant for private companies because they prepare financial statements only once a year, and that private companies often lack the accounting resources to complete this

documentation in a timely fashion. A PCC member commented that there are no additional benefits for users to complete the documentation earlier, but there is a benefit and cost savings for preparers. However, the FASB staff noted that some private company users did see a benefit, and were supportive of earlier documentation, because it prevents the occurrence of situations in which private companies are given a choice of accelerating gains or deferring losses using hindsight.

A PCC member commented that many private companies do not have CPAs on staff and do not have an understanding of hedge accounting altogether and only know how to manage their risk. These companies often do not find out about documentation requirements until they are audited at the end of the reporting period. PCC members commented that they believe that private companies should be given more flexibility to complete both contemporaneous documentation and the full quantitative and qualitative hedge documentation to be able to take advantage of hedge accounting and reduce volatility. One PCC member stated that he does not believe that documentation showing the intent of the transaction should completely alter the underlying accounting for economically identical transactions. Another PCC member commented that the accounting should be driven by the effectiveness of the hedge, and that the FASB should focus on the accounting because documentation of the intent is more of an auditing matter.

The FASB Chairman asked PCC members about the evidence they have seen to support the argument that a company should show its intent for entering into a transaction. The FASB Chairman discussed the purpose of documenting the intent as an underlying principle of hedge accounting treatment. Another FASB member also commented that without the principle, the FASB would be allowing biased financial reporting.

A couple of FASB members commented that they are sympathetic to the PCC's concerns regarding having to do an assessment at four specific points throughout the year rather than being able to assess all four points at the end of the reporting period; however, they struggle with understanding how private companies are unable to meet the contemporaneous documentation requirements regarding intent, stating that private companies should have books and records or controls surrounding who can engage in hedging and why the hedge was entered into. An FASB member commented that it should not take very long to document the intent since people are generally aware of what and why they are hedging. Another FASB member commented that without the contemporaneous documentation requirements, there would be too much optionality in applying hedge accounting.

Some PCC members commented that it may mean that an education effort would help private companies to see that the documentation requirements are not as complicated as they may have thought. PCC members also commented that a potential alternative could be to allow for private companies to have an accounting policy for hedging so that they would not have to provide documentation on a transaction-by-transaction basis. Other PCC members disagreed with forcing hedge accounting for all effective hedges because they believe that it would not be operable due to difficulties with going through all transactions to determine what is a hedge and what is effective. Several Board members agreed. The FASB staff noted that a private company can create this policy on its own and does not need standard setting to create such a policy.

The FASB staff asked why hedge accounting was important to private companies if they do not look at the accounting guidance. The FASB staff also asked whether it would be beneficial to give an example of what documentation is needed to qualify for hedge accounting. A PCC member commented that he believes that private companies have an interest in hedging documentation because they often find out about it after the fact from their auditors. That PCC member does think that adding an example would be helpful, but said that the standards are still too difficult for many private companies to get through. The FASB staff noted no relief on documentation would then be beneficial to private companies that do not read the guidance because documentation would never be prepared by the private company for the auditors, whether required at the beginning of the hedging transaction or when financial statements are prepared. However, if the issue is where to find in the guidance what is necessary for documentation, the FASB staff noted that it can include an example describing where private companies can look. An FASB member stressed the significance of transactions that cause the significant earnings volatility and questioned why controls are not in place to reduce that volatility.

A PCC member stated that identifying the effectiveness of the hedge should take precedent over the intent behind the hedge, and focusing on the documentation of the intent does not align the accounting with the economic reality. An FASB member stated that the practitioner could play a large role in assisting preparers. Another PCC member asked whether there had ever been an instance in practice in which a preparer did not want to engage in hedge accounting when a hedge is determined to be effective, to which a PCC member responded that an instrument can have gains or losses, and both can be the result of effective risk management strategies.

A PCC member believes that the FASB should eliminate the optionality and reliance should be placed on auditors to apply judgment to the facts and circumstances. FASB staff stated that many companies do not apply hedge accounting and making it mandatory would increase complexity for private companies. FASB staff reiterated that private companies must read the guidance in GAAP in order for the improvements to that guidance to be of assistance in practice. An FASB member cautioned that a potential PCC alternative here would apply to a wide range of private companies, including large multinational ones with derivatives trading desks.

The PCC Chair concluded the discussion and stated that the simplification provided in the proposal is an improvement and a good starting place that will result in more companies availing themselves of hedge accounting.

### **Invitation to Comment – Agenda Consultation: Intangible Assets**

The FASB staff provided background for the PCC discussion of the FASB's Invitation to Comment (ITC) on Agenda Consultation, emphasizing Chapter 1—Intangible Assets (including Research and Development). The staff stated that the PCC provided feedback previously that no changes should be made to current guidance on intangible assets and that the purpose of this discussion is to provide PCC members with an overview of the topic and the feedback received on the ITC, which has been surprising in that stakeholders are supporting the view that the Board add the project to its agenda. The staff discussed specific areas of discussion, such as identifying which intangibles meet the definition of an asset, how intangible assets should be measured, and

whether the recognition of intangibles would provide useful information to investors and provide benefits that justify the costs. The ITC cited four broad alternatives as potential paths forward should the FASB determine, based on input from stakeholders, that intangibles is a major financial reporting issue. FASB staff summarized the feedback from respondents pointing out that over half of the respondents listed intangibles as a first or second priority and that the overwhelming majority supported measuring intangibles at cost.

The FASB staff then solicited feedback from PCC members using the same questions that were included in the ITC, including the ones that asked whether intangibles is a major financial reporting issue that the Board should consider for improvement and whether a recognition, disclosure, or convergence approach is most appropriate.

One PCC member said that he favors recognition of more intangibles as a result of the changing economic environment and believes that the IASB threshold for recognizing an intangible asset is a good place to start. Another PCC member is troubled by putting more information on the balance sheet regarding intangible assets and believes that it could do more harm than good.

An FASB member stated that the current conceptual framework does not provide a sufficient foundation to solve this issue, specifically stating that the definition of an asset does not assist in the context of intangible assets and also that a concept for measurement is lacking. An incoming FASB member agreed with improving the conceptual framework. That FASB member cited a report issued by the AICPA that stated preparers did not favor the recognition of intangibles because it was believed that it often contained proprietary information. That FASB member said that he favors recognition and appropriate disclosure if there is a conceptual foundation, but encourages others to read the report to become informed about potential consequences and pushback from stakeholders.

An incoming PCC member stated that providing evidence of technical feasibility that is currently used in IFRS to distinguish between research and development costs is difficult in a private company environment. The PCC member believes that the process of proving technical feasibility creates an opportunity for manipulation to improve certain performance measures. Another PCC member responded by stating that, as a preparer, he favors the recognition of intangible assets for the purpose of improving GAAP and providing more relevant information to users, not for the potential incentive to improve performance metrics. Another PCC member stated that, as a lender, he expresses concern around companies structuring to improve performance measures.

An incoming PCC member favors expensing research and development costs because it is easier to apply and reduces the need for judgment. That PCC member noted that when a company is sold, historical cost on the balance sheet is not equal to fair value upon sale and an example of this is in-process research and development for a drug compound. That PCC member stated that auditing the assumptions of fair values of new drugs and new technologies is very difficult and that perhaps more guidance needs to be added around how to measure the fair value of such items. An FASB member responded to this by stating that a conceptual basis is needed for measurement.

A PCC member stated that there are difficulties in applying the current threshold for software capitalization guidance. There was general consensus that measuring intangibles using a fair value approach would be a difficult undertaking.

## **Consolidations**

The FASB staff provided an update on the consolidations project since the September 2016 PCC meeting. The FASB staff discussed the three areas for improvements: (1) Simplification and Reorganization of Topic 810, (2) Scope exception for private companies under common control, and (3) Targeted improvements to the accounting for common control arrangements. Also discussed were the decisions reached at the November 2, 2016 Board meeting; including the Board's decision to add the Simplification and Reorganization project to the FASB agenda and its request that the staff include the discussion on the scope exception for private companies and the discussion of targeted improvements in a staff draft of the proposed amendments. Some of the discussion surrounding the latter two issues included whether a scope exception should be applied to public business entities and whether the elimination of the related party tie-breaker test would resolve the issues with private companies and prevent the need for a scope exception for private companies. Additionally, the FASB staff announced that there will be a public roundtable on December 16, 2016, to solicit input and gather feedback, stating that two PCC members and a stakeholder from the AICPA's Technical Issues Committee (TIC) will be attending to provide feedback from a private company perspective.

A PCC member asked about a prior discussion regarding whether the proposed scope exception would be mandatory or optional, to which the FASB staff replied that the scope exception would be optional in the staff draft, but the question of whether the exception should be mandatory will be part of the discussion going forward. Another PCC member questioned why there would be a mandatory scope exception if entities always have the option to combine the financial statements. Another PCC member expressed concern for a mandatory scope exception for entities that will be going public in the future.

A PCC member expressed concerns about structuring opportunities and suggested additional guardrails be put around the scope exception. An FASB member also expressed concerns with potential structuring opportunities. An FASB member asked for an example of a guardrail, and a PCC member gave the example of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*. The FASB staff stated that there were mixed views from the September PCC/TIC meeting regarding the need for further guardrails and believes that the wording currently within Topic 810 accomplishes the goal that GASB Statement 61 achieves and the reorganization gives it a more prominent role. A PCC member believes that the required disclosures would serve as sufficient guardrails for potential structuring opportunities.

There was common agreement to eliminate the related party tie-breaker test, but also that the elimination of the test would not in and of itself resolve the issue for private companies and therefore additional changes should be made. Several PCC members stated that the elimination of the related party tie-breaker test would not be a simplification, whereas a scope exception would be.

## **Private Company Decision Making Framework**

The PCC Chair provided an update of previous discussions regarding potential changes to the Private Company Decision Making Framework (Guide), including a prior discussion on the wide range of companies that fall under the scope of the Guide, adding that it is a challenge to make private company alternatives based on the current scope.

Several PCC members expressed concern about situations in which an accounting result is relevant to neither public nor private companies and the Guide does not recommend an improvement solely to private companies. A PCC member stated that consideration should be made for topics that affect more private companies than public companies. An FASB member stated that the purpose of the Guide is to determine when there should be a difference in accounting for public and private companies. A PCC member cited a specific example from the September 2016 PCC meeting, where it was his belief that a proposed private company alternative was rejected based on its inconsistency with the Guide. An FASB member highlighted the view that there is a difference between having a difference of opinion on an issue and there being a flaw in the Guide itself.

A PCC member stated that the Board has taken seriously the issues of the PCC and therefore does not believe the wording within the Guide is that much of an issue since the Board has been receptive. However, the PCC member also expressed concern that private companies may sometimes be required to wait for relief until an improvement is made for public companies. Another PCC member stated that it would be good practice to undergo periodic reviews of the Guide to ensure it is still operational.

Several PCC members asked the FASB staff to identify potential areas of the Guide that are in need of improvement. FASB staff clarified that the particular areas of the Guide that are currently under debate appear to be focused on the recognition and measurement module. The staff also provided clarification that the Guide depends on the existing Conceptual Framework used by the FASB.

The FASB Chairman stated that it is always a goal of the FASB to look for ways to improve the standard setting process and asked whether the entire Guide should be reviewed or only targeted areas, bearing in mind the timing of the Disclosure Framework project currently on the FASB agenda. FASB staff suggested waiting to make changes to the Guide until the Conceptual Framework and Disclosure Framework projects make more progress.

The PCC Chair stated that the accounting resources differential factor is not highlighted enough within the Guide, and the broad scope of companies that fall under the scope of the Guide could be part of the issue. An FASB member stated that during a recent Small Business Advisory Committee (SBAC) meeting, small public companies expressed that they also have fewer accounting resources, but believe that too much focus is being placed on accounting resources in the Guide. A PCC member stated that while he does not recommend revisiting the Guide at this point, he does believe that potential improvements to the Guide should be discussed annually. FASB staff also noted that memorandums are becoming more detailed with analysis under the

Guide and suggested continuing that practice and evaluating it in the future. The FASB Chairman agreed that the scope of companies covered by the Guide is probably too broad and could be an issue to consider.

The PCC Chair called for each member to give their opinion about whether to conduct: (1) a full review, (2) a partial review, or (3) no review, but monitor.

Several PCC members stated that while it would be a difficult undertaking, the broad scope of private companies applying the Guide is an issue worth looking into. Most PCC members favored reaching out to the FASB staff to receive feedback on any issues they encounter with the Guide. However, several PCC members favored not reviewing the Guide at this time but instead monitoring it going forward.

### **Definition of a Public Business Entity**

FASB staff provided background on the issue surrounding “criterion (d)” of the definition of a public business entity, which states “It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.” The staff asked PCC members whether they have observed issues in practice and whether the staff should provide further education to clarify the meaning of criterion (d).

The PCC Chair suggested providing education on the definition as a whole, not just criterion (d), because she has received a lot of feedback from financial institutions that have expressed confusion. FASB members stated that interpreting criterion (d) as “any company whose stock is not restricted is a public business entity” was not the intention of the Board, and if that were the case, then there would be no need for criterion (e); meaning that these FASB members did not believe criterion (d) should be broadly interpreted. One of those FASB members noted that the phrase is if securities “are” traded, quoted, or listed on an exchange, not “could be.” One FASB member disagreed, but this was not consistent with the broader view of the Board.

The staff plans to provide further education on criterion (d) based on the feedback from FASB members and PCC members.

### **Open PCC Discussion**

The PCC Chair summarized the previous day’s closed meeting discussion on the basis difference in the equity method of accounting, noting that the project will not be added as a topic of discussion for the PCC Technical Agenda Consultation Group, believing that allocating the time and resources necessary to take on the project would not be in the best interest of the PCC.

The PCC Chair thanked the outgoing PCC members and stressed the importance of keeping in contact and continuing to provide input. The PCC Chair thanked everyone for their attention and the good discussion.