MINUTES OF THE APRIL 4, 2017 PRIVATE COMPANY COUNCIL MEETING

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Tuesday, April 4, 2017
Starting Time: 8:30 a.m.
Concluding Time: 12:15 p.m.

PCC Members Present:
Candace Wright (Chair)
Beth van Bladel
Steven Brown
Jeffery Bryan
Timothy Curt
David Hirsch
David Lomax
Richard Reisig
Larry Weinstock
Yan Zhang

FASB Board Members Present:
Russell Golden (Chairman)
James Kroeker (Vice-Chairman)
Christine Botosan
Harold Monk
Hal Schroeder
Marc Siegel
Larry Smith

FASB Staff Present:

Susan Cosper	*Nick Cappiello	*Mary Mazzella
Jeffrey Mechanick	*Jaime Dordik	*Rosemarie Sangiuolo
Michael Cheng	*Matt Esposito	*Andrew Thornburg
Brian McKeown	*Jeff Gabello	*Cullen Walsh
Cameron Bowen	*Dillon Jones	

*For certain issues only.

INTRODUCTORY REMARKS

Private Company Council (PCC) Chair Candy Wright opened the meeting by welcoming the four new PCC members, David Hirsch, Richard Reisig, Beth van Bladel, and Yan Zhang. The PCC Chair stated that nominations for the next rotation of new PCC members, which is scheduled for early 2018, are welcomed and encouraged. The PCC Chair also discussed plans for upcoming Town Halls in 2017, stating that Town Halls are a priority as they are an effective avenue to listen to concerns of stakeholders.

Disclosure Framework

The FASB staff introduced this topic by providing background on Proposed Accounting Standards Update, *Inventory (Topic 330): Disclosure Framework—Changes to the Disclosure Requirements for Inventory*, and sharing feedback received at the roundtable held on the Disclosure Framework project. The FASB staff concluded its introduction by discussing the next steps, which include presenting a formal comment letter summary on inventory to the Board and subsequent redeliberations.

In general, PCC members expressed concern that disclosures (for example, qualitative disclosures on costs capitalized in inventory) may become boilerplate as time passes and would not provide much additional value. A PCC member raised concern about using the same disclosures each period, and suggested giving some of the boilerplate disclosures less prominence by moving them towards the back of the notes. The FASB Chairman observed that there is already flexibility in the placement of certain disclosures in the notes to the financial statements, noting that boilerplate disclosures are an issue that the system as a whole would have to resolve.

When asked about comment letter feedback on disclosure requirements for private companies, the FASB staff stated that respondents seemed to think the differences between public and private company disclosures were appropriate. Another PCC member asked whether any feedback was given identifying specific disclosures that could be reduced to avoid disclosure overload. The FASB staff stated that each individual disclosure can be seen as useful, and it is only when one looks at the disclosures in totality along with the other proposed disclosure changes in Fair Value, Pensions, and Income Taxes, that the disclosures seem excessive.

The FASB Chairman asked whether a principle or a checklist would be more operational, noting there is a delicate balance between disclosure overload and confidence in compliance with standards. Generally, PCC members believe that a balance between the two is needed and that while a principles-based approach will require more documentation, it would be preferable to providing disclosures that users do not need.

FASB Board members acknowledged the difficulty in striking the right balance between a principles- and a checklist-based approach, noting that there is a tradeoff in prescribing more specific disclosures; it may reduce initial uncertainty, but it also may result in less meaningful disclosures. An FASB Board member stated that it is difficult to have a checklist for an individual item (inventory) that is flexible enough for different entities to use (retailers, accounting firms, and so forth), because the importance of an individual item differs by entity and line of business. Another FASB Board member stated that it is less costly to provide all potential disclosures than it is to justify the departure from providing all potential disclosures. While that FASB Board member stated that providing a comprehensive list would result in costs to users who would have to sift through the excess information, another FASB Board member disagreed stated that it is not more expensive for users to sift through this information and users prefer to have the disclosures provided and available if needed. A PCC member, who is a user, stated that he prefers more disclosures, especially if he is working through an intermediary and does not have access to management. That PCC member thought the proposed improvements to inventory disclosures are an improvement to financial reporting.

The FASB staff then discussed roundtable feedback. There was discussion surrounding the Conceptual Framework, materiality, and how there are inconsistent definitions of what is material. The PCC Chair stated that the Conceptual Framework assists the Board in making decisions and questioned the operational relevance to practitioners of placing the materiality concept in the Conceptual Framework. The FASB staff responded that materiality is an entity-specific concept and explained that there were two exposure drafts for materiality, both with amendments to the Codification and the Conceptual Framework. FASB Board members stated that there is a strong argument in favor of a consistent definition for materiality with consistent enforcement mechanisms, pointing out that the definition of materiality in the Conceptual Framework is not consistent with other definitions.

Accounting for Financial Instruments - Hedging

The FASB staff introduced this topic and the tentative decisions reached for private companies. The FASB staff discussed the Board's decision to permit private companies that are not financial institutions, to wait to conduct hedge effectiveness assessments until the financial statements are available to be issued; however, a private company must still prepare a statement of intent to hedge concurrently with hedge inception. The FASB staff also discussed other provisions in the final Update on hedge accounting that will benefit private companies.

PCC members generally supported the proposed changes, stating that hedge accounting may be applied more frequently since the documentation requirements for private companies are more aligned with their financial reporting cycle, and that the model seems simpler to apply.

PCC members asked about possible transition issues in situations in which an economic hedge exists, but the company is not applying hedge accounting. The FASB staff replied that the transition amendments have not been addressed yet and said that allowing retrospective hedging at transition could introduce complexity if entities can use hindsight as companies could selectively designate losses as hedges and not designate gains as hedges to produce an intended financial reporting outcome. A PCC member asked about the transition guidance included in the PCC alternative in Accounting Standards Update No. 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps-Simplified Hedge Accounting Approach*. PCC members asked the Board and staff to consider such a transition approach for the new decision. FASB staff also confirmed that the simplified hedge accounting approach in Update 2014-03 would be maintained.

PCC members had a discussion regarding whether financial statements lacking disclosures would be in accordance with GAAP in this case, meaning that hedge documentation would need to be completed when the interim statements are available to be issued. FASB Board and staff members stated that compliance with GAAP requires all necessary footnotes and that this decision was made to assist smaller firms that only issue GAAP financial statements on an annual basis. A staff member stated that the wording is 'interim, if applicable,' and would require the financial statements to comply with GAAP, including footnote disclosures.

Consolidations

The FASB staff provided an update on the two consolidation projects currently on the Board's agenda and discussed the tentative decisions reached by the Board at its March 8, 2017, meeting. The PCC then focused its discussion on the tentative Board decision that would permit a private company not to apply VIE guidance to legal entities under common control (including common control leasing arrangements) if both the common control parent and the legal entity being evaluated for consolidation are not public business entities.

A PCC member recommended extending the effective date and transition provisions from Accounting Standards Update No. 2016-03, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill, Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination, Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements, Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach*, to the proposed private company accounting alternative not to apply VIE guidance to entities under common control. Update 2016-03 amended existing PCC alternatives to make them effective immediately; Update 2016-03 also included transition provisions that allow private companies to forgo a preferability assessment the first time they elect a PCC accounting alternative. The PCC member recommended that future private company alternatives should be consistent with the provisions in Update 2016-03 unless there is a strong basis to deviate from such an approach. The FASB staff stated that it plans to bring this particular issue to the Board.

A PCC member asked what stage the Consolidations project will be in by the upcoming NAAATS conference in June. The FASB staff stated that a draft proposed Update has been distributed to external stakeholders for fatal flaw review, and the progress on the project will depend on the result of the feedback received.

An FASB staff member asked the PCC for feedback around superseding Accounting Standards Update 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangement*, because the requirements that must be met by a private company to qualify for the proposed accounting alternative are different from those in the current alternative in Update 2014-07. None of the PCC members raised any concerns with the different requirements. The FASB Chairman and the PCC Chair clarified that the phrasing of the proposed accounting alternative is an expansion of the current alternative, and that the phrasing would better communicate the proposal. The PCC Chair also commended the Board and the staff on the progress made on this project.

Liabilities and Equity: Down Rounds

The FASB staff provided the PCC with an update on the comment letter feedback received on the proposed Update resulting from this project. The comment letter period concluded on February 6, 2017, and the feedback was discussed by the Board at its March 22, 2017, meeting. The staff also provided an update on that Board meeting, noting that the Board did not make any decisions at that meeting but requested that the staff research a new alternative. The PCC Chair asked to be given additional insight into the new alternative. The staff said that the new alternative was a compromise between the proposal and the comment letter feedback because some Board members did not want to change the classification of financial instruments with down round features, but instead only wanted to address the issues in recognition and measurement. The new alternative was requested to see if the Board could reach a consensus.

PCC member feedback was mixed regarding the direction of the project. While some PCC members viewed the project as a simplification and recommended that the targeted project continue, other PCC members suggested that the project would be better addressed in the broader Distinguishing Liabilities from Equity project. PCC member opinions on whether the targeted improvements would reduce complexity were also mixed. One PCC member stated there should be a private company alternative that (a) allows private companies to record financial instruments that have down round features as equity, (b) allows private companies to have no accounting effect when the down round is triggered, and (c) has as its sole purpose to disclose the down round features. The same PCC member stated that accounting for the trigger of a down round feature would add complexity for private companies. The staff noted that the Private Company Decision Making Framework does not justify a difference between public and private companies and that this topic was discussed with the PCC in 2016.

An FASB member asked PCC members to clarify why they would not view this change as a simplification since, currently, preparers record fair value adjustments related to these instruments each period; in contrast, the proposal would require adjustments only if and when the down round is triggered. A PCC member stated that private companies have difficulty determining when down rounds are triggered and that while the end accounting result of the change is an improvement, the technical accounting to get there does not make the guidance easier to apply because of other accounting guidance in this area. The FASB staff stressed that the project’s intent is not to change other guidance (derivatives, convertible debt, and so forth) and that this project only addresses guidance for down rounds.

An FASB Board member stated that the alternative makes a targeted improvement to address the measurement concerns without prejudging the outcome of other projects, such as the Conceptual Framework or Distinguishing Liabilities from Equity projects. FASB Board members stated that most comment letters agreed with the equity classification in the proposed Update, while one FASB Board member said a few comment letters claimed that the classification lacked a conceptual basis. That FASB Board member believes that there is no conceptual underpinning, which would increase complexity. The FASB Chairman said that the Board is having a conceptual argument in classifying these instruments.

Cloud Computing

The staff provided an update on the pre-agenda research of a *Customer's Accounting for Implementation, Setup, and Other Upfront Costs (Implementation Costs) Incurred in a Cloud Computing Arrangement That Is Considered a Service Contract*. The staff requested feedback from the PCC to determine whether the accounting for such costs is unclear and whether it is a prevalent issue in practice for private companies.

PCC members generally agreed that the implementation process is virtually the same whether it is a cloud-based arrangement or an on-premise software license. Those PCC members did not believe that there should be fundamental differences in the accounting for implementation costs, whether there is a software license or not, because the economics of the transactions are fundamentally the same. A PCC member analogized to the concept of "right of use," which was mentioned in the Conceptual Framework discussion in the closed PCC session the prior day. That PCC member did not believe there is a right of use for cloud-based systems and it should not be recorded as an asset because the companies do not have control. The PCC member also stated it would be difficult to track and carve out implementation costs; some of her clients prefer expensing these costs.

In general, PCC members stated that tracking the implementation costs would not be difficult and would be the same for a cloud-based solution as for on-premise software. A PCC member, who is a user, stated that the benefit of capitalizing the costs would outweigh the incremental cost of tracking implementation costs. That PCC member also stated that he does not consider assets related to either internally-generated software or a cloud-based solution in his lending decisions because those assets cannot be used as a source of collateral. Another PCC member did question whether it would be difficult for smaller private companies to provide documentation to auditors regarding time spent on implementation. The PCC Chair stated that the large costs to implement switching from a cloud-based solution to on-premise software makes it prohibitive, noting that since there is no license for cloud-based solutions, the full cost is expensed. The PCC Chair also stated that, in practice, a client may have the service provider create a license to receive a desired accounting treatment.

An FASB Board member stated that some preparers said that if costs were expensed in the year incurred, the income statement would not be representative of the results of the company. Another FASB Board member stated that if the transaction is economically the same, an asset should be recorded on the books for the overall arrangement and asked whether there should be a broader project on cloud computing. A third FASB Board member clarified that since cloud computing arrangements are service arrangements, the Board previously decided that entering a cloud arrangement does not result in recognition of an asset; therefore, it is unclear what asset these implementation costs would be associated with from a conceptual perspective.

An FASB Board member and a PCC member concluded that if a company incurs implementation costs, timing of payment should not be a deciding factor in recognition. The

PCC member stated that while there are slight differences in elements of control, the differences are *de minimus* relative to the economic substance of the service one is receiving and so the accounting should be the same.

Invitation to Comment on Agenda Consultation

The discussion on the Invitation to Comment on Agenda Consultation was postponed to a later date due to time constraints.

Open PCC Discussion

The PCC Chair thanked the outgoing FASB Postgraduate Technical Assistant, Brian McKeown, and thanked everyone for their attention and participation throughout the day.