MINUTES OF THE DECEMBER 11, 2018 PRIVATE COMPANY COUNCIL MEETING

Location:	FASB Offices 401 Merritt 7 Norwalk, Connecticut
Meeting Date:	Tuesday, December 11, 2018
Starting Time:	8:30 a.m.
Concluding Time:	12:30 p.m.

PCC Members Present:
Candace Wright (Chair)
Timothy Curt
Jeremy Dillard
David Hirsch
David Lomax
Michael Minnis
Richard Reisig
Dev Strischek
Frank Tarallo
Beth van Bladel
Yan Zhang

FASB Board Members Present:
Russell Golden (Chairman)
James Kroeker (Vice-Chairman)
Christine Botosan
Marsha Hunt (FASB – PCC Liaison)
Hal Schroeder

FASB Board Members Absent:
Gary Buesser

FASB Staff Present:
Susan Cosper
Jeffrey Mechanick
Michael Cheng
Richard Cole
Cole Moffat
Darien Williams
*Jason Bond
*Lucy Cheng
*Aarika Friend
*Liz Gagnon
*Shayne Kuhaneck
*Mary Mazzella
*Francesca Roberts
*John Stansel
*Joy Sy
*Daniel Verburg

FAF Representatives Present:
*Terri Polley, FAF President and CEO
*Kim Petrone, FAF Chief of Staff

*For certain issues only.

Introductory Remarks

The PCC chair welcomed PCC members, FASB members, and FASB staff to the Council's December meeting.

Oversight Committee—PCC Review Discussion

The FAF CEO and the FAF Chief of Staff joined the meeting to notify the PCC that the FAF Trustees' Standard-Setting Process Oversight Committee (SSPOC) had met to deliberate whether another formal review of the PCC was necessary, per its oversight responsibilities. The Committee decided that a review was not necessary at this time and that it would revisit whether a review is necessary in 2020.

Town Hall Update

The PCC discussed the recent Town Hall Meeting, which was held on October 26, 2018, and hosted by the Risk Management Association (RMA) in Philadelphia. PCC members and FASB staff who were present at the Town Hall noted that while the number of participants was relatively small, the quality of the discussion and the perception of the participants was impressively high. The participants discussed many topics and accounting standards but did not have significant requests for the FASB. An observation made by one FASB staff member was that when information is important and relevant, consistency is paramount. PCC members agreed with the PCC Chair who expressed an interest in the continuation of stakeholder outreach via town halls and roundtable discussions (with a focus on smaller groups, where possible), to facilitate more effective discussions.

Disclosures by Business Entities about Government Assistance

The FASB staff provided an update on the progress of the project and sought feedback on decisions the Board made during redeliberations. The staff began by discussing issues around the scope of the disclosures, which are only required annually. Currently, the scope includes a legally enforceable agreement to receive grants of assets, tax assistance (except income taxes), and debt-related assistance. The scope excludes employee benefit plans, not-for-profit entities, transactions with the government as a customer, and assistance related to income taxes. The staff discussed the disclosure requirements, transition and effective date of the final guidance, and the next steps for the project. Feedback received from PCC members was mixed. Users generally voiced support for the disclosures, while some practitioners questioned whether the benefits to users of private company financial statements would justify the costs of providing the disclosures. One PCC member indicated that users have access through management to information and could inquire about government assistance agreements if desired. The FASB chair emphasized the simplicity of the proposed disclosures, which are primarily qualitative in nature, and highlighted that GAAP currently has no disclosure requirements about government assistance and that disclosures could therefore provide some indication to a user about significant agreements that may exist. One Board member stated that the proposed disclosures would set a minimum requirement for entities to consistently provide information about government assistance. Another PCC member noted that entities can structure government assistance to be excluded from the disclosure requirements because the scope of the project is specific and narrow. The Board member also noted that although the scope of the project is narrow, making progress in an area where there are currently no consistent disclosure requirements to provide information relevant to users of financial statements is an improvement to financial reporting.

Identifiable Intangible Assets and Subsequent Accounting for Goodwill

The FASB staff began this discussion by sharing background information on an upcoming Invitation to Comment (ITC); the ITC will solicit feedback from stakeholders about the subsequent accounting for goodwill recognized in a business combination and the accounting for certain intangible assets. Although the ITC is focused primarily on public business entities (PBEs), the staff requested feedback from the PCC to help understand implementation of the private company accounting alternatives. The staff asked PCC members whether there have been any issues implementing these alternatives. One PCC member noted that while both standards would benefit private companies, the comparative lack of awareness surrounding Accounting Standards Update No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*, versus Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*, may be an issue.

The staff had previously received feedback that private companies that have an exit strategy to become public companies are less likely to adopt the accounting alternatives because they would need to recast their financial statements. One PCC member challenged that feedback and indicated that the benefits of the alternatives are substantial even if an entity is considering going public in the future. Other members agreed, stating that the cost savings from electing the private company accounting alternatives outweigh the costs of recasting its financial statements if and when an entity decides to go public.

During the discussion on amortization period, the staff asked whether any of the PCC members had seen private companies use an amortization period other than the 10-year default period under the PCC accounting alternative. One member noted that some of their firm’s clients consider other intangible assets received as a reference point in a deal when determining the amortization period. Another member stated that all his clients use the default 10-year amortization period because they are content applying the default period. The second member added that he would prefer a 15-year period to align with the amortization period for tax purposes, which would eliminate the need for an entity to record deferred tax effects on basis differences related to goodwill. One member added that there were instances in which an amortization period over 10 years was more appropriate, but the entity was limited to the maximum default amortization period.

The members discussed comparability in a hypothetical circumstance in which there is a difference between the goodwill amortization periods of private and public companies. Through outreach, the staff learned that some public companies support a simple default amortization period similar to private companies, while others support more complex methods for determining amortization periods. One PCC member believes that a difference in the method of determining the amortization period for private and public companies is justified by differences in the needs of users of private and public company financial statements.

Several PCC members opposed complicating the private company alternatives by considering feedback from PBEs and possibly aligning an amortization period between private and public companies that could be more complex than the current PCC accounting alternative.

Distinguishing Liabilities from Equity (including Convertible Debt)

The FASB staff explained the derivatives scope exception in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, which essentially allows an entity to not apply derivatives accounting to contracts that meet certain criteria. If a contract must be accounted for as a derivative, it is generally classified as a liability and subject to other derivatives guidance, including derivative disclosures. If the contract qualifies for the scope exception, it may be evaluated under other applicable guidance and may be classified as equity. The purpose of the project is to reduce the cost and complexity of applying the derivatives scope exception for contracts in an entity's own equity. One PCC member commented on the scope of the project, noting that he would like to have seen a more comprehensive approach taken in considering improvements to the guidance for distinguishing liabilities from equity, not just a project for targeted improvements to the derivatives scope exception and convertible instruments. However, the PCC member noted that given the Board's decision to pursue such a narrow-scope project, he supports the staff's analysis and work on the project.

The first criterion in the derivatives scope exception is that the contract must be indexed to the entity's own stock ("indexation criterion"). Currently, all features of the contract must be evaluated, including any potential settlement adjustment provisions, regardless of the probability of those adjustments occurring. Remote protective provisions often disqualify the entire contract from the scope exception. PCC members generally expressed discomfort with having a non-substantive provision driving the accounting for these contracts. The staff presented three potential paths forward to address the complexity in the guidance regarding the indexation criterion. PCC members strongly supported a path that would add a likelihood threshold to the indexation criterion, resulting in substantive contract features driving the accounting for the contracts instead of remote protective provisions.

The second criterion for the derivative scope exception is that the contract meets additional and specific conditions to be classified as equity, often determined by the settlement provisions. The PCC did not specifically comment on the potential paths described by the staff but several members noted that it is uncommon for instruments to settle in cash, even if the contracts may allow cash settlement in certain situations, and those members were supportive of the effort to make the guidance less difficult to apply.

Research Project: Disclosure Improvements in Response to SEC Release on Disclosure Update and Simplification:

The FASB staff explained that as part of the Security and Exchange Commission's (SEC's) Disclosure Update and Simplification Initiative, the SEC has referred certain existing SEC disclosure requirements that overlap with (but require information incremental to) GAAP to the Board for potential incorporation into GAAP. The objective of this project is to determine whether to include the referred disclosures in GAAP and whether the disclosures should apply only to public business entities or to all entities. The FASB staff noted that incorporating these disclosures into the Codification would not substantively affect public companies but could affect private companies because SEC requirements do not apply to them.

For the SEC disclosure requirements about REITs and consolidation, PCC members were supportive of the incremental information and the relevance to private company users. PCC members were not supportive of the Board adopting the SEC disclosure requirement for any entity to disclose the names of customers who account for 10 percent or more of an entity's revenue. For the SEC disclosure requirement about related parties, PCC members indicated that current GAAP is sufficient and users would take a red flag approach if they needed additional information about intercompany profits and losses in separate financial statements. Members, including members who are users, also indicated that the SEC requirement to disclose significant changes to the authorized amount of debt since the date of the last balance sheet and the formula for calculating the number of securities available for issuance under an equity compensation plan would not be useful, which is consistent with the feedback received from users of public company financial statements.

PCC members did not oppose the disclosure requirements for assets subject to a lien and indicated that similar information is currently required for many assets under GAAP. However, some PCC members questioned what types of liens (for example, mechanic liens) would be required to be disclosed and whether an entity would be required to identify the specific assets subject to a lien. The FASB staff indicated that the language of the SEC's requirement does not explicitly require the identification of specific assets, and it does not define the specific types of liens that need to be disclosed.

PCC members indicated that discounts on shares are rare in practice, and many PCC members had never seen them in practice. The FASB staff clarified that a disclosure about discounts on shares would not affect the recognition or measurement of shares and would only be a disclosure about the recognition and measurement already required under GAAP. PCC members indicated that current disclosures under GAAP would be sufficient in situations in which knowing the amount of a discount on shares would be important.

Feedback about debt disclosures was mixed. Several members indicated that it is useful to understand the amount of unused lines of credit that an entity has access to, but other members indicated that there would be increased costs to calculate and audit that amount. Some PCC members, including members who are users, generally agreed that the disclosure of the weighted-average interest rate of outstanding short-term borrowings would not be incrementally useful, because the information needed to calculate the weighted average is already disclosed in many cases and is often more useful than the overall weighted average.

Codification Improvements—Share-Based Consideration Payable to a Customer

The FASB staff explained that uncertainty exists under current guidance about how and when to measure share-based payments made to a customer as a sales incentive or discount. To illustrate the potential difference between the two approaches, the staff used an example of a master supply agreement (MSA) that already exists but a contract is only formed when a purchase order is placed. A Topic 606 approach would require measurement of each award as of contract inception—every time a purchase order is placed. A Topic 718 approach would require measurement of the awards when the substantive terms and conditions of the arrangement are set—generally at the time an MSA is formed. At a recent Board meeting, the Board decided to codify the Topic 718 approach for measuring share-based payments to nonemployees otherwise within the scope of Topic 606. PCC members strongly supported the Board's decision not only because it is simpler for preparers and auditors, but also because it better reflects the economics of such arrangements. PCC members felt that the decision to grant awards with certain terms occurs when the MSA is formed, and those awards should be measured as of that date.

Practical Expedient to Measuring Grant-Date Fair Value of Equity-Classified Share-Based Payments

The FASB staff began by summarizing the history of the PCC's research project and outreach performed regarding accounting for share-based payment (SBP) awards. The staff reviewed a potential practical expedient that would allow a private company to assume that the price of the underlying share is equal to the strike price of the award. The practical expedient would be limited to awards granted when the company is not aware of any facts or circumstances that would indicate that the awards are probable of being issued in-the-money. The scope of the expedient as originally defined in prior meetings was limited to private company equity-classified awards granted to employees. The PCC Chair reported that the Agenda Group decided to recommend that the PCC take on this project and add it to its own Technical Agenda.

One PCC member, who is also a member of the PCC SBP Working Group, explained that the feedback from the outreach participants was generally consistent, indicating that this is a worthwhile and viable project that will reduce cost and complexity for private companies while maintaining benefits of the information for users of private company financial statements. Many PCC members acknowledged some concerns with the specific language of the expedient, but said they are confident in their ability to address those concerns as the project moves forward. Specifically, the PCC and the staff will need to clarify the qualitative threshold without using language that implies a quantitative assessment. Also, the word *assume* is not used in the Codification and may not effectively communicate the intent behind the expedient—*presume* may be a better word. Board members present generally supported the project and the PCC adding the project to its agenda, but some questioned the limited scope of the expedient to equity-classified awards (not liability-classified awards) and awards granted to employees (not nonemployees such as suppliers and customers). The staff reminded the PCC and the Board that outreach had already been performed in this area, and users had provided consistent feedback that the current accounting for liability-classified awards is relevant and should not be changed. One Board member noted that extending the expedient to liability-classified awards would not maintain the same measurement objective and essentially would become an accounting alternative for those awards. This would deviate from what the *Private Company Decision-Making Framework* would support.

One PCC member was concerned about expanding the scope of the expedient to nonemployees in part because of the revenue transactions addressed in the previous topic. One Board member noted that since Accounting Standards Update No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, aligned the accounting for SBP to employees and nonemployees, many may question why a distinction is again made here. Another Board member acknowledged that the external economic drivers for setting the strike price of SBPs to customers may be entirely different from the drivers for employees. In fact, some vendors may be more incentivized to issue in-the-money awards to customers when adverse tax consequences do not come into play.

One Board member noted that private companies going public may have increased costs if this expedient were to be finalized. That concern was noted in the accompanying Agenda Paper for the meeting, and one PCC member was confident that the population of companies issuing SBP to employees but not going public is still broad enough to provide substantial cost savings to the system. The Board member suggested speaking with SEC staff members while the project progresses to determine whether they would allow newly-public companies to use the expedient in comparative periods (periods when the company was not yet public).

PCC Chair Candy Wright called a vote to add a project focusing on the SBP practical expedient to the PCC Technical Agenda. All 11 PCC members voted in favor of adding the project (which is now named PCC Issue No. 18-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Payments"), to the PCC Technical agenda. They requested that the staff continue to refine the language in concert with the SBP Working Group and conduct additional outreach regarding the language of the expedient in preparation for the next PCC meeting in April.

Open Discussion

The Open Discussion focused on accounting for cryptocurrency and its prevalence in GAAP financial statements. The FASB will continue to monitor the progress of the AICPA's Virtual Currency Task Force and its forthcoming publication that will address both the accounting for and auditing of cryptocurrencies.

The PCC chair concluded the meeting by thanking staff members for their preparation for the meeting and everyone for their participation.