Private Company Financial Reporting Committee
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November 20, 2012

Private Company Council
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Dear Members of the Private Company Council:

The Private Company Financial Reporting Committee will cease its existence on December 31, 2012. In the interest of continuity, we present the following report which summarizes recent PCFRC activities, some lessons learned and suggestions that the PCC may find useful as well as our thoughts on FASB projects that the PCC may want to monitor.

The PCFRC began its existence in 2007 by attempting to make changes to two existing standards- FIN 48- *Accounting for Uncertainty in Income Tax* and FIN 46R- *Variable Interest Entities*. FIN 48 had just been enacted and included pass through entities and not-for-profit organizations in its scope. We attempted to gain an exemption from the standard for private companies as we believed the problem this standard was designed to address was a public company issue. The Board did not grant an exemption but did agree to extend the effective date for private companies. As a result of further PCFRC outreach work, the Board also provided additional guidance for pass through entities with ASU 2009-06. While certain narrow issues remain with FIN 48 (ASC 720), we feel that these are lower priority items for the PCC and FASB.

We also made numerous recommendations to address issues that private companies had in understanding and applying FIN46R which were not considered by the Board. The lessons learned were 1) it is very difficult to change an existing standard and 2) a case has to be made as to what is different in the private company world that would warrant an exception. We believe we have made great progress in educating the Board and staff about private companies and most of this is captured in the Private Company Decision Making Framework that the PCC will be considering and, hopefully, adopting.

The lessons learned from attempting to change existing standards led us to begin monitoring FASB projects from their inception and working closely with staff to ensure that private company issues identified by the PCFRC are considered by staff and the Board as the project proceeds. Waiting until an exposure draft is issued is generally too late in the process to effect any change. Because each member of a volunteer body such as ours cannot possibly follow each FASB and EITF project, we assigned each project to a task force consisting of 2 or 3 PCFRC members, one of whom was designated the leader. FASB staff was provided with the task force list. During recent years, a private company staff person was embedded in each project and was in contact with the PCFRC task force as issues arose. This took the form of emails and conference calls. The process worked extremely well as PCFRC was able to raise concerns with staff as the Board deliberated aspects of a project. The PCFRC highly recommends that PCC adopt this process since the PCC is now charged with monitoring ongoing FASB projects in addition to their work on existing standards.

The PCFRC decided early in its existence that it did not have the expertise to comment on projects directed to financial institutions. We monitored financial instruments projects only for their effects on financial instruments that a non-financial institution private company may hold such as accounts receivable and payable and interest rate swaps. We commented on the difficulties inherent in level 3 valuations and how users perceived them.

The PCFRC maintains a website: www.pcfr.org and through that website we built a "resource group" of people who signed up to be kept informed of PCFRC activities and whom we could contact for input on projects. We surveyed this group for outreach on FIN48 and FIN46R and included their input in our recommendation letters. Although we have not used the resource group recently, the list has been turned over to FASB staff for use by PCC. We suggest that the PCC devise a process for outreach to its constituents in addition to a section on FASB's website.

PCFRC was also in close contact with the AICPA's Technical Issues Committee and was privy to their discussions on various projects. Because our members were also involved with other professional organizations, we used that as leverage to work with organizations like FEI, IMA, RMA, AGC, CFMA, Surety Association of America and venture capital organizations among others when commenting on various FASB proposals. We recommend that PCC maintain and cultivate these relationships.

We have found the Board and staff in the past two years to be very receptive to our thoughts and ideas. We were very pleased that, upon our suggestion, the Board took on the project on Goodwill Impairment. After making convincing arguments about how users of private company financial statements ignored goodwill in their decision making process, the Board allowed a qualitative assessment of impairment for private companies- and then extended that to public companies. We suggest that the PCC focus solely on its mandate to evaluate current GAAP for private companies only. As evidenced by the Goodwill Impairment project, the Board will expand the scope when warranted. This could be accomplished through the endorsement process that the Financial Accounting Foundation has implemented.

The PCFRC members were not always in agreement on issues. Users sometimes disagreed among themselves and with practitioners and preparers. The Board encouraged us to present all views and our comment letters often presented opposing views with the reasons for them.

Below is a list of ongoing FASB projects and the related PCFRC comments/concerns. All of these have been communicated to either the staff, Board or both. The PCFRC comment letters on these and prior projects as well as meeting minutes can be accessed at www.pcfr.org.

Discussion Paper, *Private Company Decision Making Framework* ("Framework")

The PCFRC has been deeply involved with this project since its inception and several PCFRC members were part of the working group. We commended staff on their work on this document. Some comments that were made in our letter dated October 29, 2012:

- Going forward in the development and use of the Framework, consideration should be given to acknowledging that there is a distinction between the primary users of private company financial statements and all users of the statements. Not all users of private company financial statements have the same level of access to management. Consideration should also be given to addressing how different levels of access affect the implementation of the framework. In addition, consideration should be given to addressing how identifying the primary users of a private company's financial statements might affect the different areas of the Framework.
- The PCFRC recommends that a scalable, rather than binary, approach be applied when determining which types of entities should be included in the scope of the Framework. With a scalable approach, some entities would be included in the full scope of the Framework and others would be included only within the scope of certain parts of the Framework or alternatively on a standard by standard basis. For example, conduit bond obligors could be allowed to avail themselves of differential effective dates but perhaps not all differential disclosures.
- The PCFRC believes it is premature to discuss whether a company adopting one recognition or measurement exception should have to adopt all. This discussion would be more appropriate once the Board and PCC have made such exceptions and then it should assess the overall effects of these on private company financial reporting.

Proposed Accounting Standards Update, *Disclosures about Liquidity Risk and Interest Rate Risk*

The PCFRC issued a comment letter on this proposed ASU on September 25, 2012. The discussion below is extracted from that comment letter. For some reason PCFRC was not consulted by staff on this project and provided no input prior to the issuance of the exposure draft. The PCFRC has observed that projects which are originated due to concerns with financial institutions, but apply to all companies, may not receive broad constituent input in the development stage.

Overall, the PCFRC is concerned that the potential benefits of the liquidity risk disclosures are not sufficient when weighed against the cost to private companies of preparing the disclosures. The PCFRC recommended that limitations on the required disclosures be introduced into the Proposed ASU. The PCFRC recommended a triggering mechanism to limit these disclosures. This triggering mechanism could be similar to the triggering mechanism being developed by the Board for the Going Concern project. Financial statement user members of the Committee contend that, by and large, they would be aware of a company's liquidity risks and problems long before the proposed disclosures would reach them. However, users agree that there is some value to liquidity risk disclosures summarized in a cash flow obligations table and an available funds table.

Therefore, the PCFRC recommends limiting the proposed disclosures to private companies that are undergoing challenges to their liquidity and are under financial duress. (PCFRC members recognize that identifying a triggering mechanism for the proposed disclosures that the management of a company could apply may be problematic.) Introducing such limitations would greatly narrow the range of private companies that would incur additional cost in preparing the proposed disclosures. At the same time, financial statement users would receive relevant information about cash flow obligations and available funds from those companies that are actually having liquidity problems. It is our understanding that these comments were passed on to the staff working on the going concern project.

Other concerns we addressed on this issue:

- PCFRC recommended that if the ASU stands as proposed, the disclosures be required only for annual private company financial statements (including conduit debt obligors).
- PCFRC is unclear about what kinds of cash flow obligations will need to be disclosed beyond the examples presented in paragraph 825-10-55-5d of the Proposed ASU. For example, what would be included in “other obligations?”
- The PCFRC recommends that the FASB further clarify the meaning of the term “expected maturity”, how a preparer at a non-financial institution private company would operationalize that term, and how it differs from “contractual maturity”. Preparers will be required to exercise judgment when applying the term “expected maturity” and reporting inconsistencies could occur when expected cash flow obligations are presented by companies.
- The financial statement user members of the PCFRC assert that when a private company has a liquidity problem, users normally are aware of it long before the proposed disclosures would inform them of the problem. Liquidity disclosures are time-sensitive. By the date lenders, sureties, venture capitalists and other users receive financial statements from a private company, such disclosures will lose some relevance. In addition, current analytical measures, such as asset and liability turnover ratios, working capital calculations, and basic indicators of liquidity in the balance sheet, serve users well in providing decision-useful information about liquidity risk. Nevertheless, the user members of the Committee believe that the summarization of liquidity disclosures in a table can be of some assistance in their analyses and decision making. However the additional cost incurred by private companies in complying with the proposed disclosures appear to outweigh the marginal benefits to users
- Some PCFRC members are of the opinion that disclosures about expected cash flow obligations should only be required for two years beyond the financial statement date. Other members believe that such disclosures would be useful for a period of five years beyond the financial statement date. In any event, the PCFRC believes that aggregating three years of expected cash flow obligations (i.e., 20X4-20X6) would be less beneficial than presenting the individual years’ obligations.
- The PCFRC recommended that the FASB clarify its intent with regard to the disclosure of contributions to defined benefit pension plans. The example expected cash flow obligations table presented in paragraph 825-10-55-5d of the Proposed ASU displays dashes (“-“) in the columns beyond one year for the

"contributions to defined pension plans" line. However, the Proposed ASU contains no explicit statement that cash flow obligations representing contributions to defined pension plans should only be disclosed for one year.

Proposed Accounting Standards Update, *Presentation of Items Reclassified Out of Accumulated Other Comprehensive Income*

The PCFRC issued its comment letter on October 18, 2012. PCFRC members believe that the concept of other comprehensive income may be irrelevant to many non financial institution private companies and their financial statement users. These members recommend that other comprehensive income be defined from a conceptual standpoint. Once defined and clarified, the concept of other comprehensive income can be better assessed for relevance in the private company sector. Without a clear definition, use of other comprehensive income tends to confuse users as to what is net income, which is a relevant measure for private company financial reporting stakeholders. The PCFRC recommended that this is an issue that the Private Company Council could address.

Financial Instruments project

- In a discussion with the Board the PCFRC 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 current expected credit loss allowances.
- The PCFRC is concerned that, given the title of the project, private companies may not be aware of the changes related to providing a current expected credit loss allowance for trade receivables under the proposed model.

Leases Project

The PCFRC has been involved with this project from the beginning and wrote a comment letter on the ED addressing certain private company issues as well as other general thoughts. We have been educating staff and the Board about private company related party leases and held conference calls to provide the FASB staff with more detailed information as the Board prepared to address this.

- The PCFRC has identified unwritten and month to month leases as common practice among private company related parties. The Board tentatively decided not to provide specific guidance on recognition and measurement for related party leases. Some PCFRC members are concerned that the lack of a substance qualification (similar to what exists in current GAAP) will provide structuring opportunities. The Board tentatively decided to emphasize the requirements for related party disclosures with, at a minimum, a link to related party guidance.
- 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. The Board tentatively decided that nonpublic entities should be provided a practical expedient to use a risk-free discount rate, with a term comparable to that of the lease term, as an accounting policy election for all leases. If an entity elects to use a risk-free discount rate, that fact should be disclosed.

The PCFRC was very pleased that the Board specifically addressed these concerns. The staff plans to solicit feedback from the Private Company Financial Reporting Committee and the Private Company Council to determine questions for the invitation to comment section in the Revised Exposure Draft on Leases. The PCFRC will recommend that the questions in the ITC include the board's decisions on these private company issues.

Consolidations: Related Party Leasing Arrangements

When the PCFRC was established in 2007 one of the first items on the agenda was FIN 46R and its applicability to private company related party entities. Many suggestions were made to the Board over the years which were never fully addressed. At its November, 2011meeting the PCFRC had presented FASB staff with five common related party leasing scenarios and sought staff clarification on how FSP FIN 46(R)-5, *Implicit Variable Interests under FASB Interpretation No. 46* would be applied. The staff worked with one of the examples and concluded that there could be some confusion on how this would apply and whether FIN 46(R)-5, *Implicit Variable Interests under FASB Interpretation No. 46*, should be amended. The staff presented four alternative approaches for discussion with the PCFRC at our October, 2012 meeting: 1) establishing a narrow scope practical expedient to private companies, 2) providing implementation guidance on VIE assessment for related party arrangements, 3) providing educational material, and 4) consider a broader research project to understand the concerns from private company constituents on application of VIE guidance. The PCFRC believed that more implementation guidance is needed on what constitutes a VIE. A follow-up conference call was held with staff and the PCFRC concluded that perhaps a clear example of how the related party "tie breaker" would apply would be a way to provide a short term fix and agreed that a broad research project should be undertaken. This will be discussed more fully with the SBAC at its January meeting. The PCFRC is hopeful that it can end its existence with some clarification on this issue. If not, the PCFRC urges the PCC to follow up on this effort.

Going Concern

The Committee provided feedback to the FASB staff on the kinds of possible disclosures management of private companies should be required to make concerning going concern issues. Some Committee members thought that requiring early warning disclosures would be beneficial; however the wording of such disclosures could be problematic. In addition, early warning disclosures could end up promoting a "checklist" mentality to assessing going concern, which would be detrimental to financial reporting.

Revenue Recognition

The PCFRC followed this project from its inception and issued several comment letters as the project progressed. Of special concern was its effect on construction contractors as most of them are private companies. We worked closely with Construction Financial Management Association and Associated General Contractors on this project. Some of our concerns in the later stages of the project were:

- Wasted materials

- Accounting for goods the customer obtains control of significantly before receiving services related to those goods/stored materials
- Take or pay contracts
- Time value of money
- Transition- PCFRC did not believe that private companies should be required to retrospectively apply the proposed ASU
- Contingent consideration- the PCFRC did not believe that revenue should be recognized until the contingencies have been removed

Investment Property Entities

The PCFRC believed that the way the proposed ASU was drafted would not include the typical private company real estate leasing entity which we believed was the desired outcome. If this project is reactivated, the PCC should monitor it for its effect on these types of entities.

Discussion Paper*: Disclosure Framework*:

The PCFRC had an initial discussion of the DP at its October meeting and raised the following points:

- The Private Company Decision Making Framework covers disclosures. Assuming that framework is adopted by PCC and this document is approved by the Board as either part of the conceptual framework or in the codification, which document prevails when the Board is considering private companies?
- Tiered approach in paragraph 3.11c has some conceptual appeal.
- A possible problem with making this a Concept Statement is that it has no authority.
- More examples would be helpful. In paragraph 2.20 the document states that staff had tested the decision questions by applying them to various topics. It would have been helpful if the results of that exercise had been included in the document.
- The supposition that judgment needs to be applied in applying the guidance should be added to the Framework.
    - Seems that the Framework is trying to have preparers exercise judgment when making disclosures; however the success of that is problematic because standards have specific requirements and the Framework would not be authoritative.
- The approach for private companies should be a base minimum level of disclosures and then add on disclosures on a case-by-case basis.
- Some of the Framework guidance appears to be more like MD&A- for example Questions L5, L6 and O6. Private Companies are not required to disclose MD&A type items.
- The concept of materiality needs to be addressed. Preparers would need to consider materiality when deciding to make a disclosure.

Derivatives and Hedging:

In our October 21, 2010 comment letter on *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* the PCFRC recommended that nonfinancial institution private companies be exempted from the scope of the proposed ASU.
Some members of the PCFRC disagree with the FASB's proposed elimination of the shortcut method related to hedge effectiveness and recommend that it be maintained for private companies. They believe that elimination of the shortcut method will result in increased audit fees with little perceived benefit. Other PCFRC members are not that concerned with the elimination of the short-cut method. Because the qualitative approach is required and only a reasonably effective threshold needs to be met, they believe a permutation of the short-cut method will survive. However it will not be the same prescriptive method that is used today. Furthermore, the PCFRC recommends that the final standard contain an example of accounting for a plain- vanilla interest rate swap which is the most common derivative in the private company world

In a letter dated April 26, 2011 the PCFRC commented further on hedging:
As the FASB moves forward in developing changes to hedge accounting, the PCFRC recommends that a simplified approach to the accounting and reporting for interest rate swaps and their related caps and collars be considered for private companies. Any proposed changes should avoid a high volume of accounting over the long life of these instruments. Measuring hedge effectiveness and allocating gain or loss to net income and other comprehensive income over the life of these instruments would be costly and time-consuming for private companies. The accounting would not produce information that would be relevant or decision-useful to private company financial statement users, who focus on cash flow and eliminate hedge effectiveness valuations from their analyses. Ideally, the accounting for these instruments should result in recognizing the interest on the basis of the swap –usually variable to fixed interest, therefore recognizing interest on a fixed basis.

Emerging Issues Task Force

EITF Observer

The EITF recently granted the PCFRC chair observer status at its meetings. EITF meetings are highly technical in nature and some of the items are of limited interest to most private companies. However, certain items can be of acute interest. It will be important that a mechanism continues to allow private companies to provide appropriate feedback on EITF matters at the table.

EITF Issue No. 12-F, *Recognition of New Accounting Basis (Pushdown) in Certain Circumstances*

This is a new EITF issue which the PCFRC has been monitoring. New Basis and Pushdown accounting questions are common with private companies, in particular with venture capital and private equity owned entities. The AICPA hotline has indicated that this is active area for questions from members. Fundamentally, unlike SEC registrants, no authoritative guidance exists on pushdown accounting for private companies. The PCFRC supports authoritative guidance for private companies on pushdown accounting which broadens the application of the purchase method. However, the details of any guidance in this area are important to monitor.

Two Projects that the PCFRC was following but which are now inactive:

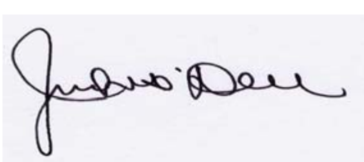
***Financial Statement Presentation*-April 14, 2009 Comment Letter on the Discussion Paper:**

- Private company lender-user viewpoint was that the current model is adequate. The proposed model offers negligible benefit besides direct method cash flows. Lenders will incur major costs to change analysis systems if the proposed model is finalized
- Private company venture capitalist-user viewpoint was that aspects of the proposed model are useful improvements, but too much disaggregated detail is a concern. Industry-specific reporting is important and the proposed model needs to consist of principles, not rules.
- Private company preparers and practitioners believed that the proposed model will impose a substantial cost burden and that the proposed model fails to incorporate widely-used metrics like EBITDA.

***Financial Instruments with Characteristics of Equity*- May 23, 2008 comment letter on Preliminary Views.**

This project was of particular concern to private company venture capitalists. The PCFRC believes that the Ownership Settlement approach is a preferable approach, which includes enhancements to current GAAP. In some cases, this approach will bifurcate the more complex instruments, giving users a clearer picture. Although challenges exist with the Ownership Settlement approach that need to be addressed, it presents a better alternative than the Basic Ownership approach. Instruments whose value fluctuates primarily with (and in the same direction as) the value of the issuing enterprise as a whole, as opposed to the ability of the enterprise to repay the holder a stated amount, are distinguishable as equity instruments
The PV does not appear to address common stock owned by ESOP-owned private companies.

The PCFRC wishes the PCC much success and our members stand ready to help in any way with the transition.



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