MINUTES OF THE SEPTEMBER 11, 2019 PRIVATE COMPANY COUNCIL MEETING

Location:	FASB Offices 401 Merritt 7 Norwalk, Connecticut
Meeting Date(s):	Wednesday, September 11, 2019
Starting Times: Concluding Times:	8:00 a.m. 12:20 p.m.

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

PCC Members Absent:
David Hirsch
Beth van Bladel

FASB Board Members Present:
Russell Golden (Chairman)
James Kroeker (Vice Chairman)
Christine Botosan
Marsha Hunt
Gary Buesser
Susan Cosper (FASB – PCC Liaison)

FASB Board Members Absent:
Hal Schroeder

FASB Staff Present:

Shayne Kuhaneck	*Mary Mazzella	*Rachel Cole
Jeffrey Mechanick	*Lucy Cheng	*Nick Japhet
Richard Cole	*Chris Roberge	*Tyler Padgett
Jenifer Wyss	*James Starkey	*Emma Lazar
Rebecca Harris	*Aarika Friend	*Kelly Garrett
Demi Fritz	*Bobbi Gwinn	*Alexia Jentgen
*Alex Casas	*Joy Sy	
*Alicia Posta	*David Challen	

*For certain issues only.

Introductory Remarks

The PCC chair welcomed PCC members, FASB members, and FASB staff to the PCC's September meeting. In addition, she acknowledged the members of the AICPA Private Company Practice Section Technical Issues Committee (TIC) who were observing the meeting.

Town Hall and Other Meetings Update

The FASB staff provided an update of the PCC panel held on August 13 at the American Accounting Association (AAA) conference in San Francisco. The staff noted that the intention of the panel was to share the history and purpose of the PCC with the academic community, while spreading awareness of existing private company accounting alternatives.

The staff also discussed the PCC roundtable held on August 13 with the National Venture Capital Association (NVCA) in San Francisco. The staff highlighted the following key discussion points, organized by topic:

- Share-Based Payments (SBP): Participants discussed the view that the nature of SBP awards often depends on the stage of the company and the level of the employee. The discussion indicated that there is a continued trend towards issuance of restricted stock units and management incentive units rather than traditional stock options. Participants noted that an Internal Revenue Code Section 409A compliant valuation is not overly costly to obtain and suggested that absent current requirements, they would generally rely on the Section 409A valuation to determine current price.
- Effective Date: Participants expressed support for the proposed effective date philosophy and highlighted the importance of providing private companies with the opportunity to learn from public companies.
- Leases: While only one participant (whose firm invests in a company licensing lease accounting software) indicated that they have completed implementation of the lease standard, several participants noted that their leases typically are not voluminous or complex.
- Credit Losses: Participants indicated that they would not be largely affected by the new credit losses standard because they already use key elements of an expected loss model for their trade receivables.
- Software Capitalization: Participants discussed complexities associated with determining technological feasibility.
- Financial Performance Reporting: Due to concerns about a lack of consistency among reporting entities, participants suggested that the Board consider defining the terms *cost of goods sold* and s*elling, general, and administrative*. When the project scope was explained to the participants, they were supportive of the project to disaggregate cost of goods sold and selling general administrative expenses.

The PCC discussed two upcoming outreach meetings:

1. Members of the PCC, FASB, and FASB staff will be participating in a PCC Town Hall at the California Society of CPA's Accounting & Auditing Conference in the Los Angeles area on October 24.
2. Following a highly successful Private Company Roundtable in October 2018, the Risk Management Association (RMA) expressed interest in setting up another roundtable

with members of the PCC, FASB, and FASB staff for fall 2019. Details are forthcoming.

Implementation Topic—Leases

The staff updated the PCC on its current monitoring and outreach efforts with both public and private companies for the implementation of the lease standard. The staff highlighted that they are actively monitoring certain areas of concern related to the standard and noted that the TIC brought forward several simplification suggestions. These were discussed in detail at the FASB/TIC Liaison Meeting held later in the day on September 11, 2019.

One PCC member noted that additional guidance on related party lease transactions would be beneficial. Specifically, the member noted that guidance would be useful to determine lease term in a related party lease. The FASB chairman clarified that the PCC member's fundamental question was whether the Board intended for the lease term to be the contractual term in all situations. The staff confirmed that a related party lease term should consider all legally enforceable terms and should often be analyzed in the same manner as an unrelated party lease. The FASB vice chairman noted that the decision was made in order to promote consistency between standards and that it was unanimously supported by the PCC at the time of the development of the lease standard. He further explained that the decision not to infer terms and conditions that are not legally enforceable and to rely instead on related-party disclosures, is consistent with related-party transactions in other areas of GAAP (for example, revenue).

The PCC chair discussed the difficulties associated with accounting for embedded leases and suggested that additional education may be needed. The FASB vice chairman indicated that, dependent on the outcome of the current project on effective dates, the Board plans to continue to perform outreach to gain a better understanding of the issues faced by companies and to determine whether education is needed or whether more formal solutions should be developed. The FASB chairman noted that it has become clear that although currently required under existing leasing guidance, embedded leases have not been thoroughly tracked and included in the commitment table disclosure.

Identifiable Intangible Assets and Subsequent Accounting for Goodwill

The FASB staff updated PCC members on the Invitation to Comment, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill* (the ITC),which is currently out for comment, and specified that the ITC is a staff document seeking feedback on multiple subjects, including but not limited to whether to change the subsequent accounting for goodwill, whether to modify the recognition of intangible assets in a business combination, and whether to add or change disclosures. The staff noted that the reason why this ITC was issued is because of the mixed feedback received from preparers and users of public company financial statements.

PCC members expressed the view that the PCC alternatives (from Updates 2014-02 and 2014-18) for goodwill accounting are widely supported by members of the private company community and should be maintained.

Much of the ensuing discussion focused on PCC feedback on the characteristics of a goodwill amortization period. PCC members provided feedback on the amortization period that private companies use when electing the PCC alternative. Under that alternative, the useful life is 10 years, or a period of less than 10 years if the private company demonstrates that another useful life is more appropriate. Other PCC members noted that some private companies amortize goodwill using a period of less than 10 years, and not just in transitional instances involving older acquisitions.

PCC members also discussed whether goodwill amortization should be an option or a requirement.

Additional discussion ensued about whether the period of amortization between public and private companies should be aligned if an amortization model were to be applied for public companies. One PCC member commented that it would not be problematic to have different periods for goodwill amortization between private and public companies and added that the main challenge would be the explanatory rationale. In response, the FASB chairman highlighted that if amortization were implemented for public companies, the basis for a difference in amortization period for private companies under the Private Company Decision Making Framework (PCDMF) would be reconsidered.

At the conclusion of the session, the FASB staff shared the timeline of the ITC and asked any PCC members interested in participating in the upcoming roundtable on November 15, 2019, to let staff know.

Effective Dates Philosophy

The FASB staff provided an update on the proposed Update on staggering effective dates between larger public companies and smaller public companies, private companies, and not-for-profit organizations for major accounting standards. The staff highlighted that the philosophy was applied to the following major standards in the proposed Update:

1. Hedging
2. Leases
3. Credit losses.

Broadly, PCC members were in support of the philosophy to stagger effective dates using a two-bucket approach whereby bucket one would include public business entities that are SEC Filers, excluding entities eligible to be smaller reporting companies (SRC) in accordance with the SEC definition, while bucket two would include all other entities. They generally supported having a two-year delay between the effective dates of the two buckets for major standards and indicated that they generally want the option to early adopt those standards. A PCC member noted that the Board should have the flexibility on a standard-by-standard basis to increase or decrease the deferral period.

Comparability of financial statements was then discussed. One Board member asked about the extent to which prior interim financial statements need to be adjusted for comparative purposes if accounting standards are adopted in interim periods subsequent to the annual financial reports. One PCC member noted that whether comparability is required depends on the standard.

The conversation concluded with a discussion about whether private companies should continue to get an extra year (the year after a standard is effective for annual periods) for interim financial statements given the increased lag in effective dates between bucket one and bucket two, noting that many private companies do not prepare interim financial statements and for those that do, it would require additional work to have a mismatch for standards that have an income statement impact. One PCC member noted that he adopted accounting standards in interim period reports the same year in which they were adopted for annual financial statements when he was a private company preparer. Other PCC members expressed support for allowing interim reporting in the subsequent year, rather than the same year as annual reporting.

Reference Rate Reform: Facilitation of the Effects of the Interbank Offered Rate Transition on Financial Reporting

The FASB staff began the discussion by highlighting key aspects of the proposed Update, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The staff then asked for feedback from PCC members on several issues.

First, the staff asked PCC members about the progress companies and other organizations have made in identifying and mitigating risks of the transition away from LIBOR and other reference rates affected by the reform. One PCC member responded that their clients are only aware of the issue if their lender has notified them. Two other PCC members noted that while their clients may be aware, there has been no movement. Another PCC member explained that clients are prioritizing other issues above the LIBOR transition. In response to a Board member question, two PCC members responded that they have not heard from their clients on whether bank examiners are asking about the progress of transition.

Second, the staff asked for feedback on the proposed Update that is out for public comment. PCC members broadly supported the proposed expedients. One PCC member stated that the proposals would be easy to implement.

Third, the staff asked PCC members for feedback on potential disclosures that should be provided about an entity’s exposure to reference rate reform and the financial reporting effects of the proposed expedient(s) elected. Two PCC members wanted qualitative disclosures about the purpose of reference rate reform and the new rate used, as well as a quantitative disclosure of the effect of the replacement of a rate. From a user perspective, one PCC member would prefer broad disclosures and cautioned against quantitative disclosures.

Lastly, the staff asked PCC members about whether they agree with the sunset provision and the operability and auditability of the proposed guidance. PCC members were in favor of the sunset provision because the date is adjustable if needed. In response to why a sunset date is necessary, staff responded that it is because the hedge effectiveness test will be temporarily suspended as a result of the hedge accounting relief, and GAAP is currently on point in evaluating contract modifications.

The staff emphasized the message to stakeholders that the sunset date should focus on the end of LIBOR and other reference rates affected by the reform since the accounting relief will expire one year after LIBOR ends.

Distinguishing Liabilities from Equity (Including Convertible Debt)

The FASB staff began the conversation by reminding PCC members that the proposed Update, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and*

Contracts in an Entity's Own Equity, is currently out for public comment.

The FASB staff explained that the project's objective is to simplify the accounting for convertible instruments and contracts in an entity's own equity. Under this objective, the accounting for convertible instruments would be simplified by eliminating several separation models and would provide a more simple and straight-forward starting point for users to perform their analysis. The FASB staff then described the derivatives scope exception by focusing on three major proposed changes to GAAP, including considering likelihood when evaluating the indexation and settlement criteria, eliminating three of the seven additional conditions for equity classification under the settlement criterion, and reducing the frequency of reassessments. The staff emphasized that although many disclosure requirements in the proposed Update appear to be new, much of the guidance has simply been reorganized for clarity. The staff concluded its update by (1) discussing the transition method and transition expedients included in the proposed Update and (2) asking the PCC members for feedback related to implementation and specific private company considerations.

Four PCC members expressed their support for the simplifications included in the proposed Update, noting that it is a "good step forward" and should simplify the accounting for those affected. Two PCC members further stated that, given the simplification nature of the proposed amendments, they are supportive of early adoption.

Several PCC members commented on the Board's decision to remove *settlement permitted in unregistered shares* from the additional conditions for equity classification under the settlement criterion. In response to the PCC chair's request for clarification, the staff responded that there is currently a condition that prohibits equity classification if an entity is required to settle in registered shares. The staff further noted that by removing the condition, an entity no longer has to analyze whether it will settle in registered or unregistered shares. However, there is still a condition requiring sufficient authorized and unissued shares to settle a contract. In addition, the staff explained the concept of reassessment upon a triggering event and noted that if at the beginning of the contract an entity did not have sufficient authorized and unissued shares but later got board approval, that would qualify as a reassessment event and the entity would be able to reclassify from liability to equity, provided that all other aspects of the derivatives scope exception are met.

Simplifying the Balance Sheet Classification of Debt

The FASB staff updated the PCC on the project's progress and estimated that the revised proposed Update would be issued as early as Thursday, September 12, 2019.[1] In addition, the staff provided background on a consequential issue associated with the debt classification principle, which is the principle for determining whether debt would be classified as a noncurrent liability. The staff explained that in scenarios in which a debt arrangement is contractually required to be entirely settled through the issuance of equity, the Board clarified that an entity would determine the classification of debt on the basis of when the liability is contractually due (regardless of the form of settlement).

PCC members engaged in a wide-ranging discussion about the Board's decision on equity-settled debt, and several members suggested that an argument could be made that such arrangements should be classified as equity rather than a liability. However, even if determined to be classified as

[1] The revised proposed Update, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent),* was issued on September 12, 2019.

a liability, not all PCC members agreed with the Board's decision that classification should be determined based on *when*, rather than *how*, the debt is settled. One PCC member suggested that the purpose of classifying debt as current or noncurrent is to provide information about an entity's liquidity and solvency, or an entity's ability to meet its short and long-term financial obligations. As a result, the PCC member noted that *how* the debt is settled is important because debt that has no claim to a company's current assets should never be classified as a current liability, regardless of when it is settled.

Alternatively, other PCC members expressed support for the Board's clarification, noting that a current liability classification would be appropriate for a debt arrangement that is contractually required to be entirely settled through the issuance of equity within a year of the balance sheet's release date. Two PCC members supported the Board's clarification because (1) it is consistent with the simplification objective of the project and does not add additional complexity in the form of an exception to the general rule and (2) it is not common for private companies to have share-settled debt. Other PCC members supported the decision because they fundamentally believe that the purpose of classifying debt as current or noncurrent should be to provide information about *when* the debt will be settled.

The PCC chair concluded the session by discussing issues associated with the Board's decision on unused long-term financing arrangements. She recognized that certain not-for-profit entities have expressed concerns about the Board's decision, but she acknowledged that in a for-profit, commercial environment, she believes the decision was appropriate.

PCC Issue No. 2018-01, "Practical Expedient to Measure Grant Date Fair Value of Equity-Classified Share-Based Awards"

The FASB staff updated members of the PCC on the recent outreach performed with private company preparers. The outreach consisted of a survey sent to over 1,000 preparers, to which the PCC received a total of six responses. One practitioner PCC member acknowledged that the preparer survey response rate was low but indicated positive feedback based on personal outreach to clients that issue traditional share-option awards. The PCC and Board expressed agreement that, due to the low overall response rate, the survey was not statistically valid. In determining next steps for obtaining preparer feedback, the FASB chairman acknowledged the extensive prior outreach with preparers and noted that some of the potential paths forward may not need to be further contemplated by preparers.

The PCC and Board then discussed the pervasiveness of the issue, which has also been an area of discussion at several past PCC meetings. One Board member suggested that the PCC and Board consider whether a practical expedient for determining current price would be widely utilized. The Board member further noted that there may be other areas of GAAP where the PCC could potentially have more impact, such as share-based compensation disclosures or profits interest awards. In response, one PCC member highlighted that the issuance of equity-classified traditional share-option awards is pervasive and material to a subset of private companies and that the pervasiveness discussion should not be generalized across the whole population of private companies.

The FASB chairman then shifted the discussion to the cost savings provided by a potential practical expedient. He clarified that when developing a private company practical expedient, the PCC and

Board ultimately have to determine whether the expected benefits justify the expected costs. The chairman noted that this particular project is more about cost savings than providing an additional benefit, and, as a result, he highlighted that a viable solution needs to have a clear cost savings. One Board member cited paragraph 1.3 of the PCDMF, which states that "the term *practical expedient* means a more cost-effective way of achieving the same or a similar accounting or reporting objective" and noted that there has not been a compelling argument made for the reduction of cost. One PCC member responded that the cost savings of the potential practical expedient[2] are twofold. First, he suggested that less cost would be incurred in preparation because preparers would be able to uncouple the Topic 820 fair value concept from the notion of the current price input. This uncoupling would ensure auditors and preparers are not preoccupied by obtaining a perfect, and costly, fair value measurement. Additionally, while audit costs cannot be eliminated altogether due to additional audit procedures surrounding whether an entity qualifies for the expedient, the PCC member asserted that overall audit fees would likely still be reduced. The FASB vice chairman indicated that he would support a practical expedient when (1) clear cost savings can be determined and when (2) the expedient is grounded in something other than an assumption.

The FASB chairman and vice chairman then suggested an alternative practical expedient for the PCC to consider. Rather than relying on an assumption, they suggested incorporating language that aligns the measurement philosophy for determining the underlying share price with the measurement philosophy articulated in Internal Revenue Code Section 409A. The FASB chairman noted that such a solution would eliminate the need for an entity to perform two separate valuations by stating that the entity would not have to do more to be GAAP compliant than what is being performed to comply with Section 409A. The FASB chairman further highlighted that such a solution provides a clear representation of a cost savings, which would not need to be further contemplated by private company preparers before moving forward.

Two PCC members confirmed that the proposed solution would, in substance, provide a simplification and accomplish the overall goal of the expedient. However, the PCC chair raised a concern with basing an accounting standard on a tax code that is subject to change. The FASB vice chairman noted that tying the expedient to something subject to change is preferable to tying it to nothing. However, one Board member noted that not every company obtains a Section 409A compliant valuation, which would further limit the population of private companies likely to adopt the practical expedient.

One practitioner PCC member noted that if the newly identified expedient were in place, they would work with their clients to determine how to save costs by satisfying Section 409A without obtaining a detailed external valuation. The PCC chair responded that, at least for her clients, this potential expedient would save significant costs. One Board member, along with a preparer PCC member, discussed the usefulness of an accurate valuation for private company preparers and noted that the valuation often has real economic implications including, and incremental to, its use in share-based compensation arrangements. As a result, they asserted that many preparers would likely continue to obtain a formal external valuation and noted that it is unclear whether, and to what extent, there would be an overall cost savings.

When discussing next steps for the project, two PCC members noted that they prefer the original

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[2] Detailed in paragraph 28 of the meeting materials, [Agenda Topic 8: PCC Issue No. 2018-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards"]

potential practical expedient language, but they provided support for exploring the option identified by the FASB chairman and vice chairman. The PCC discussed potential steps forward, which included issuing an Invitation to Comment or an Exposure Draft. Ultimately, the PCC decided to proceed with the drafting of an Exposure Draft based on the Section 409A solution identified during the meeting. To conclude the meeting, the PCC and Board directed the staff to begin drafting the Exposure Draft and to distribute the draft language for the practical expedient, along with any outstanding issues and solutions, to the PCC for discussion before the upcoming December PCC meeting.