

October 17, 2016

Susan M. Cospers, CPA
Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: FASB August 4, 2016 Agenda Consultation Invitation to Comment [File Reference No. 2016-290]

Dear Ms. Cospers:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Agenda Consultation Invitation to Comment (ITC) and is providing the following comments for your consideration. For simplicity, the terms "private companies," "nonpublic entities," and "private entities" are used interchangeably in this letter.

GENERAL COMMENTS

As noted in the ITC, now that many of the major projects are complete, the FASB has begun to consider other major areas of financial reporting for which improvement might be warranted. TIC has identified 4 areas, in addition to those identified by the FASB, that the FASB should consider adding to their agenda. These 4 areas are discussed further in question 1 of this letter, and are as follows:

1. Employee share-based payments for private entities
2. Equity method simplification for private entities
3. Elimination of fair value disclosures for held-to maturity debt securities of private entities
4. Weighted-average disclosure exemptions for private entities—intangible assets and leases

On the basis of the results of the Financial Accounting Standards Advisory Council (FASAC) survey and other input from stakeholders, the FASB identified the following major financial reporting topics to include in this ITC:

1. Intangible assets (including research and development)
2. Pensions and other postretirement benefit plans
3. Distinguishing liabilities from equity
4. Reporting performance and cash flows (including income statement, segment reporting, other comprehensive income, and statement of cash flows)

TIC agrees that all 4 of these issues identified by the FASB are areas where improvements could be made to U.S. GAAP. In this letter, TIC addresses areas where we think the FASB may want to consider additional projects, prioritizes the 4 items that FASB has set forth in the ITC based on TICs input and discussions, and provides some additional context and information for FASB's consideration related to these top 4 items identified in the ITC.

In addition, TIC suggests that the current liabilities versus equity project be completed and users be given the opportunity to review the revised guidance in ASC 480, *Distinguishing Liabilities from Equity*. The FASB may also want to consider taking another look at the specific assets and liabilities required to be measured at fair value under existing guidance before a new project is undertaken in this area.

SPECIFIC COMMENTS

1. *Are there major financial reporting issues that are not considered in this ITC that should be addressed by the FASB before any of the issues discussed in the ITC are addressed? What are the considerations or criteria that you used to identify these issues? Please describe any of those issues and your perspective about how the FASB should resolve the issues.*

TIC does have some additional financial reporting issues that we believe should be considered by the FASB, many of which were discussed in our September 29, 2016 meeting in Norwalk with select FASB staff and Board members. Those 4 issues are discussed in further detail below.

Share-Based Payments for Private Entities

The first issue relates to employee share-based payments for private entities. TIC believes that the current guidance in ASC 718, *Compensation—Stock Compensation*, can be very onerous and costly to apply for private entities and does not necessarily result in useful information for stakeholders. TIC recognizes that in March 2016, the FASB issued ASU 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. While this ASU made some much needed improvements in the area of stock compensation, TIC believes the FASB should look at additional relief for employee share-based payments for private entities.

In TIC's discussions on simplifications regarding recognition, measurement, and disclosure of share-based payment transactions, TIC discovered unwarranted cost and complexity around certain share-based payment disclosures. TIC then reviewed the required disclosures related to share-based payment awards issued to employees and identified opportunities to simplify or eliminate certain disclosures that do not provide useful information to users of nonpublic entity financial statements.

TIC's conclusions, in part, are based on a number of factors which include, but are not limited to:

- the lack of marketability of the instruments (restrictions on transfer to third parties);
- infrequency of exercise (generally, exercise is due to a triggering event such as an IPO or sale.);
- disregard of the disclosures by investors and other users (viewed as not important);
- the tendency for users to "carve out" compensation expense from operating income to present, in their minds, "true" operating income; and
- frequency of errors in disclosures prepared by management. Share-based payment disclosure requirements can be extensive. In addition, preparers frequently do not place emphasis on the disclosures because they are not perceived to be significant to the users of the financial statements of nonpublic entities. Therefore, the perceived lack of relevance and the complexity of the disclosure requirements lead to errors in practice.

Therefore, TIC recommends that the Board eliminate the following required disclosures under ASC 718 for nonpublic entities:

ASC 718-10-50-2(c):

For the most recent year for which an income statement is provided, both of the following:

- a. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or share units)*:
 - i. Those outstanding at the beginning of the year
 - ii. Those outstanding at the end of the year
 - iii. Those exercisable or convertible at the end of the year
 - iv. Those granted during the year
 - v. Those exercised or converted during the year
 - vi. Those forfeited during the year
 - vii. Those expired during the year

- b. The number and weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value...) of equity instruments not specified [above] (e.g., nonvested shares), for all of the following groups of equity instruments*:
 - i. Those nonvested at the beginning of the year
 - ii. Those nonvested at the end of the year
 - iii. Those granted during the year
 - iv. Those vested during the year
 - v. Those forfeited during the year

ASC 718-10-50-2(d):

For each year for which an income statement is provided, both of the following:

- a. The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method, or intrinsic value for awards [whose fair value is too difficult to measure]) of equity options or other equity instruments granted during the year
- b. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year

ASC 718-10-50-2(e):

For fully vested share options (or share units) and share options expected to vest at the date of the latest statement of financial position, both of the following:

- a. For options (or share units) outstanding:
 - i. The number of options (or share units)
 - ii. Weighted-average exercise price (or conversion ratio)
 - iii. Weighted-average remaining contractual term
- b. For options (or share units) currently exercisable or convertible:
 - i. The number of options (or share units)
 - ii. Weighted-average exercise price (or conversion ratio)
 - iii. Weighted-average remaining contractual term

ASC 718-10-50-2(i):

As of the latest balance sheet date presented, the following:

- a. The total compensation cost related to nonvested awards not yet recognized; and

- b. The weighted-average period over which the total compensation cost related to nonvested awards not yet recognized is expected to be recognized

* TIC believes nonpublic entities should continue to disclose shares outstanding at the end of the year, which would include the number of vested and nonvested awards at each balance sheet date presented. Generally, the activity during the year doesn't provide relevant information to users of financial statements.

A second issue related to employee share-based payments are forfeitures and clawback provisions. TIC members feel that there could be some simplification and relief for private companies in this area as well.

TIC suggests that the FASB take another look at the requirement to reverse cumulative compensation expense recognized for nonvested shares that have been forfeited. The basis of our recommendation is as follows:

- Nonpublic companies tend to disregard this requirement. In other words, they discontinue recognizing compensation expense associated with the forfeited awards but, generally, do not recapture the previously recognized compensation expense.
- Compensation expense should be recognized so long as the employee is providing services during the holding period of the award, regardless of vesting. Some TIC members viewed this as part of an employee's compensation and should be recognized as such regardless of any forfeitures.

The final issue related to employee share-based payments relates to the recognition of deferred tax assets for underwater options. Under the current guidance in ASC 718, even when options become "underwater," U.S. GAAP still requires any deferred tax assets related to those stock options to remain on the balance sheet. This seems counterintuitive and not in line with other accounting principles where assets must be written down once impairment is imminent. While TIC understands that addressing this issue also could have an effect on other areas of U.S. GAAP where deferred tax assets are not evaluated at each reporting cycle for impairment, TIC does feel this could be an area for the FASB to explore further as writing down those related deferred tax assets would present a better financial picture of the entity at a point in time.

Equity Method Simplification for Private Entities—Accounting for Basis Differences

The FASB recently removed a project from their agenda to address equity method simplification. TIC feels that the FASB should reconsider some targeted improvements related to the accounting for basis differences of equity method investments for private entities. TIC members have noted that this guidance can be complex and

costly to implement, and many private entities are either not aware that they should be accounting for these basis differences at each reporting period, or they fail to record these adjustments in their financial statements due to the fact that, many times, the resulting adjustments are not material to the financial statements.

TIC also believes it would be appropriate to subsume intangibles into goodwill and amortize out over a defined period, perhaps 10 years. The basis for our recommendation is two-part. First, the basis difference information tends to be irrelevant to users. Second, TIC is quite confident that users of nonpublic company financial statements are not aware of accounting for the basis difference, which leads to errors and inconsistency in practice. This may be due to the lack of presentation and disclosure requirements. This recommendation would, among other things, provide more consistency among practitioners in practice.

Elimination of Fair Value Disclosures for Held-to-Maturity Debt Securities of Private Entities

TIC feels that many of the fair value disclosures for held-to-maturity debt securities for private entities can be costly to implement and does not provide decision-useful information to stakeholders. TIC would ask the FASB to consider some disclosure relief in this area for private entities.

As it pertains to ASC 320-10-50-5(a), amortized cost has relevance for fixed income held-to-maturity securities, as the intent is to hold until maturity, while receiving interest over the term and ultimately return of principal. For available-for-sale securities, the securities could be sold prior to maturity and fair value of those securities takes on a greater level of relevance to users.

As for the requirement in ASC 320-10-50-5(aa), if the aggregate fair value is available, one could argue that it would provide useful information. If a portfolio is material, this disclosure would have more relevance than if the portfolio was immaterial.

With regard to the current disclosure requirements in paragraphs 5(c) and 5(d) of FASC 320-10-50 related to gross unrecognized holding losses and net carrying amounts, TIC is not sure if these disclosures justify the cost since conceptually holding fixed income securities until maturity will allow for the holder of the instrument to recover any unrealized gains or losses experienced over the term of the security at maturity. Generally, the holder of held-to-maturity securities isn't focused on fair value but, rather, on the income stream associated with the held-to-maturity security and recovery of their principal at maturity. If the securities were available-for-sale fixed income, then TIC could see where unrealized holding gains/losses would be relevant since the securities wouldn't necessarily be held to maturity and the unrealized holdings at a point in time would provide a user with relevant information on potential realized gains/losses exposure.

ASC 320-50-5(d) requires disclosure of the net carrying amount by major security type as of each date for which a statement of financial position is presented. Net carrying value could be relevant in situations where the instrument has been impaired at some point since acquisition of the instrument. However, there could be other avenues to pursue such as impairment disclosures, if those impairment disclosures were deemed robust, that could provide a user with information that would be indicative of credit quality of the fixed income security.

ASC 320-10-50-5(f) requires disclosure of information about the contractual maturities of those securities as of the date of the most recent statement of financial position presented. TIC is not sure if the benefit in providing this information justifies the cost. While TIC can appreciate and understand the usefulness of the timing of cash flows, users of private company statements may already be aware of this information based on their closer relationship with the entity/management which raises the question as to whether the cost to provide this information correlates into additional decision useful information.

Weighted-Average Disclosure Exemptions for Private Entities—Intangible Assets and Leases

TIC has noted that certain weighted-average disclosures may not be as useful for private entities. Specifically, TIC feels that the weighted-average disclosures required related to goodwill, other intangible assets, and leases in ASC 350-20-50, ASC 350-30-50, and ASC 840-20-50, are onerous and costly for private entities to apply, and would not typically affect any decisions made by key stakeholders or potential investors.

2. *What is your view about the priority of addressing the major financial reporting issues addressed in this ITC? In other words, is addressing one or more of the issues more critical than others? Please describe your assessment criteria and why you prioritized certain issues above others.*

TIC has prioritized the issues based on the order provided below, and also provided some background and rationale for that prioritization for the FASB to consider when setting its future project agenda.

Distinguishing Liabilities Versus Equity

Most TIC members agree that distinguishing liabilities from equity should be a top priority for the FASB. This is an area where the guidance could use some clarification and there is some diversity in practice on how this guidance is interpreted. The Center for Plain English Accounting, of which most of the TIC members are a part, also receives numerous questions each year on debt versus equity issues. Some of these questions relate to the relationship between the guidance in ASC 480 and other areas of U.S. GAAP, including the financial instruments and derivatives and hedging guidance, and how this effects the evaluation of whether an item should be classified as debt or as equity.

In prior meetings with the Board, TIC has discussed the accounting for equity-linked financial instruments containing “down-round” features (such as convertible debt with warrants) and simplification of the accounting for these instruments. Warrants in particular could be an area for the PCC to address to see if some relief and simplification can be made for private entities.

TIC is aware that the FASB does have a current project on their agenda to make some targeted improvements to this guidance, including some improvements to the readability of ASC 480 and simplification of some of the current guidance. This includes removing the indefinite deferral guidance brought about with the issuance of FASB Staff Position FAS 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests Under FASB Statement No. 150*. As noted later in this letter, TIC would suggest that the FASB wait until this guidance is finalized and stakeholders have a chance to review and apply it before making any further simplifications or targeted improvements to the guidance in ASC 480. However, TIC members all seem to agree that some additional relief and simplification is necessary in this area.

Reporting Performance and Cash Flows

TIC noted from investor research that classification shifting by management changes investor behavior. TIC members are concerned that if FASB standardizes a definition of an entity’s operating activities, there could be industries where this could present an issue. For example, certain operating measures in one industry might be considered part of the entity’s integral operations, while for another industry it might be considered non-operating. In addition, development of industry-specific guidance seems to be counter to a principles-based approach.

Under Alternative A proposed in the ITC, the FASB would reexamine the current guidance in ASC 225, *Income Statement*, on infrequently occurring transactions or events. This approach would redefine the U.S. GAAP definition for infrequency of occurrence to apply a more conventional understanding of this term. In its place, a range of factors would be considered when evaluating an item’s frequency of occurrence. The objective of this approach would be to display the effects of infrequently occurring transactions and events separately from other performance components.

Under Alternative B, there would be a requirement to identify and define a type of earnings component that is termed a remeasurement, which would isolate changes in the carrying amounts of existing assets and liabilities that are recognized in net income (for example, fair value gains and losses). These transactions or events may recur at each reporting period but do not recur in the same amount. Alternative B also may include a separate presentation of the items identified in Alternative A.

Under Alternative C, functional lines would be disaggregated into natural components. This alternative includes describing the characteristics of both natural and functional lines to separate a functional line into natural components. This approach potentially involves aspects of distinguishing both infrequently occurring items and remeasurements.

TICs preference is Alternative A. TIC prefers the idea of emphasis and breaking out infrequent items separately on the face of the financial statements. It may also be beneficial to include a disclosure concerning operating activity that explains the nature of the reporting measure of operations or items excluded from operations. This is consistent with typical Not-for-Profit entity disclosures.

TIC thinks that Alternatives B and C seem to be a byproduct of Alternative A (i.e. Alternative A is involved conceptually in how Alternatives B and C are developed). Additionally, Alternative B seems to introduce additional costs and complexity with regard to financial reporting, while Alternative C doesn't seem to go far enough so that TIC questions how robust Alternative C would be if, ultimately, this was the direction of the FASB.

TIC did agree that the presentation of cash flows is a major financial reporting issue that the FASB should consider for additional improvement, as there is often inconsistency in reporting non-cash activities as well as the correct classification of items. TIC noted that while the FASB recently issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, to address eight specific issues, perhaps there is additional opportunity for the FASB to clarify how certain items should be presented. For example, many times entities struggle with whether certain items should be presented gross versus net on the statement of cash flows.

Intangible Assets

Disclosing more robust information on internally generated intangible assets, such as brands and logos, supply agreements with terms that are more favorable than current market terms, specially-trained employees, noncompetition agreements, collaboration agreements, goodwill, and data, might provide users with better information. A survey conducted in 2006 showed that investors would utilize such information in their decision-making processes. TIC members were in agreement that a disclosure approach would be preferable to a recognition and measurement approach.

However, if the FASB is interested in converging U.S. GAAP with IFRS, then it appears that research and development is the place to start. IAS 38, *Intangible Assets*, issued in 2004, specifies recognition criteria for capitalizing initial costs incurred to acquire or internally generate an intangible asset and subsequent costs incurred to add to, replace part of, or service the asset. An entity is required to recognize an asset if the intangible asset is identifiable and if the following criteria are met:

- a. It is probable that the expected future benefits that are attributable to the asset will flow to the entity
- b. The cost of the asset can be measured reliably

The primary difference between current U.S. GAAP and IFRS in this area relates to the accounting for Research and Development.

Recognition of an intangible asset if a threshold is met and measurement of that asset at fair value would likely result in (a) a gain in the period in which the asset initially is recognized and (b) gains or losses in each period for the change in the fair value of the asset. TIC believes that, if the item is recognized on the balance sheet, changes in recognition and subsequent valuation should be recognized in the income statement.

Pensions and Other Postretirement Benefits

TIC does not have many clients with active pensions that follow FASB accounting (most follow GASB standards). Therefore, TIC has put this as a last priority. However, we do have some comments regarding the options being proposed by the FASB.

Under Option A, converging with IAS 19, TIC believes this would address some of the concerns about smoothing. This alternative would eliminate recycling of the effect of past economic events into earnings and eliminate the effect of actuarial gains and losses from the income statement. This alternative also would present net interest on the net defined benefit liability (assets) in the income statement.

Under Option B, some may think that recognizing changes immediately in earnings would make earnings more representative of the current period's economic transactions and events. Certain entities already recognize all gains and losses immediately in their income statements. However, most of those entities then report non-U.S. GAAP measures eliminating the effects of immediate recognition from their reported results. While Alternative B is simpler and resolves many of the perceived issues about smoothing, many would argue that it results in unfavorable outcomes, such as increased earnings volatility. However, the recently issued Exposure Draft on the presentation of net periodic pension cost and net periodic postretirement benefit cost could mitigate this concern. If the Exposure Draft were to be finalized, actuarial gains and losses would no longer affect operating earnings. Under Alternative B, the Board would have an opportunity to consider whether interim reporting should be performed on the same basis, thus potentially requiring remeasurement at each reporting date.

3. *Is it necessary to resolve one or more of the issues before resolving others? In other words, is the resolution of any of the issues dependent upon the resolution of one or more other issues? Please identify any of the projects that should be completed before others and why.*

TIC believes that in order to undertake a project related to liabilities versus equity, the FASB may consider first taking another look at what assets and liabilities are required to be measured at fair value under the existing guidance. TIC is also aware that the FASB currently has a project to make targeted improvements to the guidance on liabilities versus equity. Items currently in the scope of this project are:

- Determining whether an instrument (or embedded feature) is indexed to an entity's own stock, specifically as it relates to features for which the strike price adjusts down on the basis of the pricing of future equity offerings (Phase 1)
- The indefinite deferral in ASC 480 for mandatorily-redeemable financial instruments of certain nonpublic entities and certain mandatorily-redeemable noncontrolling interests by replacing the deferral with a scope exception (Phase 1)
- Improving the navigation within the FASB *Accounting Standards Codification*®

TIC believes that once these changes are made to ASC 480, stakeholders should be asked to review what is remaining in ASC 480 and where additional improvements can be made.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Michael A. Westervelt". The signature is written in a cursive, slightly slanted style.

Michael A. Westervelt, Chair
PCPS Technical Issues Committee
cc: PCPS Executive and Technical Issues Committees