AICPA® PCPS
Private Companies Practice Section

November 2015

Technical Issues Alert

Information on technical issues affecting small businesses and the CPAs who serve them.

TIC Meets with the FASB

At its annual liaison with the FASB, TIC expressed appreciation to the FASB staff members who participate in TIC phone calls and meetings. TIC members have frequently participated in the development stages of FASB projects and offered outreach sources in the past, and TIC chair Scot Phillips reiterated committee members' willingness to continue their involvement. The FASB often surveys CPAs, preparers or users who might be affected by a proposed standard and TIC offered recommendations on using electronic surveys that could enhance and streamline the process and encouraged the staff to include more nonpublic companies and their financial statement users in its outreach efforts.

Projects discussed included:

- *Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting***.** TIC thanked the FASB for taking on the project as part of its Simplification Initiative, since committee members believe there could be many opportunities to reduce complexity while maintaining user relevance. TIC supported virtually all of the proposed simplifications, but thought further steps could be taken to lower complexity, especially for nonpublic companies, and particularly in the area of disclosures. TIC also encouraged the FASB to consider opportunities to reduce the complexity of fair-value measurement in the valuation of private company stock-based compensation, and to engage in further outreach to affected constituencies to gather broader perspective.

- *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities.* TIC appreciated the FASB's efforts to reduce the complexity and create consistency among not-for-profit (NFPs) entities. However TIC expressed concerns that, as proposed, the standard may create a more complex framework which may be less useful to NFPs and users of their financial statements. The development of intermediate measures of operations and the proposed definition of operating activities, moving some disclosures from the face of the statement of financial position to the notes, and a new requirement for certain quantitative liquidity disclosures are areas of concern.

- ***Leases.*** TIC members expressed their appreciation for the board's efforts to pursue simplification of the upcoming lease accounting standard from the positions taken in the earlier EDs. However, TIC members also raised numerous questions, including asking about the validity of classifying operating leases as an obligation, noting that many similar commitments aren't included on the balance sheet.

- *Simplifying the Balance Sheet Classification of Debt*. Regarding this project still in process, the board is proposing a new debt classification principle which would require decisions about the classification of debt to be based on the facts and circumstances surrounding an entity's contractual rights and obligations that exist as of the reporting date (i.e., the balance sheet date), without consideration of subsequent events—a principle that is consistent with current IFRS. However, based on input received from TIC and other groups, the board has granted an exception to the proposed classification principle and has decided to generally retain noncurrent balance sheet classification for debt subject to covenant violations at year-end that are waived by the lender after the balance sheet date but before the financial statements are issued. Unfortunately, the board has not granted an exception for short-term debt expected to be refinanced on a long-term basis after year-end but before the financial statements are issued. During the liaison with the board, TIC members argued against classifying such debt as a current liability. TIC believes classification should follow current guidance, which allows a short-term obligation to be excluded from current liabilities as of the balance sheet date if the entity has the ability and intent to refinance the debt on a long-term basis before the financial

FUTURE MEETINGS

TIC meetings offer local practitioners the chance to provide their unique perspectives in the standard-setting process. All CPAs are invited to attend. Contact Linda Volkert, CPA, TIC Staff Liaison, at the AICPA at (212) 596-6040 to learn about attending or receiving information on upcoming meetings.

The next TIC meetings will be held:

- January 12 and 13, Sarasota, FL, including TIC's annual liaison meeting with the ASB.

The PCPS Technical Issues Committee (TIC) provides standard setters with the unique perspective of local CPA firms on accounting, auditing and reporting issues. We hope these highlights of issues that affect local firms will help you, your firm or your group to participate in the standard-setting process.

statements are issued, as specified in *Accounting Standards Codification*™ section 470-10-45. TIC members noted potential unintended consequences that could have an impact on financing and bonding (the latter for construction clients), that could force them to face additional costs and complexity, and might put them at a disadvantage when it came to seeking financing. The FASB expects to issue an ED on this project before the end of the year. TIC encourages all practitioners to study the ED carefully, discuss the proposal with lenders and, if possible, submit your views to the board.

- ***Hedge accounting*.** TIC supported the board's overall direction for this segment of the financial instruments project, but also pointed out some concerns and areas where clarification might be needed. The board expects to issue an ED in the first quarter of 2016.

- ***Effective Date and Transition Guidance for PCC ASUs***. FASB added this proposal to its agenda to address concerns raised by private company stakeholders (including TIC) regarding preferability and transition issues when electing a private company accounting alternative for the first time after its effective date. Its official title is: Intangibles—*Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), and Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (A Proposal of the Private Company Council).* TIC discussed possible unintended consequences of assigning an effective date and was pleased that the proposal would remove the effective dates from the existing ASUs that represent PCC consensuses. TIC also asked for future guidance on assessing preferability.

On a separate note, the FASB also recently issued the ED, *Revenue from Contracts with Customers (*Topic 606*): Narrow-Scope Improvements and Practical Expedients*. The amendments in this proposed update address specific issues that the FASB-IASB Joint Transition Resource Group for Revenue Recognition brought to the board's attention, including the assessment of the collectibility criterion for the identification of a contract with a customer, accounting for revenue received when the agreement with the customer does not meet the definition of a contract, presentation of sales and other similar taxes collected from customers, noncash consideration and other issues. None of the proposed amendments would affect the core principles of Topic 606. TIC's comments on the ED will be discussed in the next issue of the *TIC Alert*. ■

TIC Discusses Issues with the PCC

TIC's outreach also includes the FAF's Private Company Council, which considers alternatives to existing GAAP to address the needs of private company financial statement users. The incoming chair of the PCC, Candace Wright, as well as two of its members---Tom Groskopf and Jeff Bryan—are former TIC members. At TIC's private session with the PCC, the two groups discussed several issues that TIC also addressed with the FASB (see separate article), as well as:

- Applying Variable Interest Entity Guidance to Non-Leasing Common Control Arrangements. TIC has provided sources for outreach on this PCC research project, which includes common control arrangements other than leasing. TIC members expressed appreciation that the PCC is addressing the topic.

- Simplifying the Equity Method of Accounting. TIC discussed its comments on this ED, which would no longer require investors to identify, account for or disclose the difference between the cost basis of an investment and the investor's proportional interest in the investee's equity.

- Liabilities & Equities—Targeted Improvements. Recent decisions in this project in process address the accounting for equity-linked financial instruments (such as warrants or convertible debt) with a down round feature, which stipulates a reduction in the exercise price specified in the contract in certain circumstances. The board also plans to convert the indefinite deferral in Topic 480 related to mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests to a scope exception ■

Clarifying Intent in a Project on Principal vs. Agent Considerations

Based on outreach with the FASB staff on a proposed ASU, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, TIC confirmed that contributions are subject to the guidance on variance power and are not within the scope of this or other guidance related to the new revenue recognition standard. Principal versus agent considerations would apply to all entities with contracts with customers, including not-for-profits. TIC generally agreed with the ED's proposals. ■

TIC Liaison with the GASB

TIC maintains key contacts with the GASB not only through its annual liaison in Norwalk, CT, but also when GASB staff members participate in interim discussions of new EDs and projects in development. At their most recent liaison, TIC and the GASB chair and staff members addressed these issues:

- *Accounting and Financial Reporting for Irrevocable Split-Interest Agreements.* TIC members generally agreed with the proposed accounting treatment, noting the need for guidance in this area, and discussed several points in its comment letter on this ED.

  1. TIC asked for implementation guidance, including illustrative journal entries on accounting for transactions.

  2. The proposal would apply to split-interest agreements associated with a trust or "equivalent arrangements." TIC asked that GASB either define that term or replace it with "legally enforceable contracts," since that's likely what the term would encompass.

  3. TIC asked for more information on how to incorporate risks when valuing the lead interest beneficiary on a split-interest agreement. The ED's discussion of this subject also seemed to imply that present value techniques might not always be used, so TIC asked for guidance on when that could be the case.

  4. The ED calls for measuring the liability payable to other beneficiaries at its settlement value. TIC asked for greater clarification on whether this settlement value would be measured at the inception of the agreement only or remeasured throughout the life of the agreement.

- *Blending Requirements for Certain Component Units.* TIC asked the GASB to clarify the definition of "sole corporate members" discussed in the proposed ED: specifically, that these are those defined in the NPO's bylaws and stated in its articles of incorporation. TIC also suggested clarifying the treatment of component units organized as limited liability companies--and also clarifying that the new standard would amend GASB Statement No. 14 as amended by Statement No. 61.

- *Financial Reporting for Fiduciary Responsibilities.* A previous *TIC Alert* noted that TIC member Ted Williamson presented on this project as well as the one on leases (see below) at a GASB open forum. At the liaison, TIC asked about the board's plans in light of comment letters it received on the preliminary views document. In particular, TIC was interested in whether the board would consider any further carve outs, exemptions or scope exceptions. On another front, the board has replaced the word "citizenry" with the term "residents or recipients of the government's goods and services." Although TIC noted in its comment letter that it did not believe the word "citizenry" was sufficiently clear, it questioned whether the new definition was an improvement. Also, in asking for clarification on the envisioned classification of items such as student activity funds at a school, TIC noted that scoping these funds into governmental activities could have the unintended consequence of lowering the school district's state funding, since fund balance levels in governmental funds are often analyzed in order to determine the amount of such funding that a district will receive. That could motivate districts to move these funds into separate entities, which might mean there would be less rigorous controls over them.

- *Lease Accounting.* Regarding the treatment of lease contracts involving multiple underlying assets in this project under development, TIC members noted situations in which relatively small items, such as copier leases, might now need to be capitalized under the proposal, and described why this might pose difficulties for smaller governments. TIC also expressed concern that GASB's proposed approach to capitalizing and amortizing what are now treated as operating leases would not add value for users and be burdensome for governments and asked for simplification on this front. TIC also recommended that the timeframe for short-term leases be expanded beyond one year. TIC reported on a field test performed by a committee member who found that the proposal would add a significant volume of disclosures and expressed concern about the burden for governments. Given the need to address possible consequences associated with debt covenants and grant funding, TIC requested sufficient time between the time an ED is finalized and becomes effective.

- *Implementation experience with GASB Statement No. 68, Accounting and Financial Reporting for Pensions.* TIC, which noted that the standard represented a significant change, pointed out areas where further guidance or clarification is needed. TIC members reported a great deal of diversity in practice regarding the reversal of deferred outflows from the prior year and the definition of covered payroll. TIC also discussed timing issues for governments where the measurement date differs from the financial statement date and noted the need for more guidance in that area. TIC also discussed problems related to allocations when various risk pools are joined together in one plan.

- *Financial Reporting Model.* This ongoing project is re-examining GASB Statement Nos. 34, 35, 37, 41 and 46 and Interpretation No. 6. According to the GASB, the major areas to be reconsidered include management's discussion and analysis (MD&A), government-wide and fund financial statements, capital asset reporting, budgetary comparisons, special purpose government reporting and related notes to the financial statements. (See also separate article below.) Issues discussed at the liaison meeting included TIC's concerns about the government-wide statement of activities and cash flow statement and potential proposals regarding the basis of accounting for governmental funds, which TIC urged the board to reconsider to make them easier for boards to understand. TIC also encouraged the board to consider changing the criteria for what can be discussed and what should not be discussed within MD&A.

- *Asset Retirement Obligations.* TIC was given background details on the project's focus.

In other GASB activities, the board issued GASB Implementation Guide 2015-01. Its requirements are to be applied simultaneously with the requirements in GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.* ■

GASB Revisiting Blueprint of Governmental Financial Statements

The GASB plans to reexamine the financial reporting model for state and local government financial statements to improve the existing model, which was established in 1999 through Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and subsequent related pronouncements. The board says that the reexamination will benefit from research the GASB staff has conducted with users, preparers, and auditors of governmental financial statements over the past two years on how the financial reporting model is functioning in practice.

Statement 34 established the present structure for state and local government financial reporting—the format and contents of the basic financial statements, certain related notes to the financial statements, and required supplementary information including management's discussion and analysis (MD&A). One of its most significant additions to the reporting model was the introduction of government-wide financial statements containing accrual information—which notably includes the reporting of infrastructure, other capital assets, and long-term liabilities.

The project will consider improvements to major features of the financial reporting model, including MD&A, government-wide financial statements, major funds, governmental fund financial statements, proprietary fund financial statements and budgetary information. In each of these areas, the board said it will continually seek opportunities to reduce the complexity of financial statements, which could positively impact the timeliness of governmental financial reporting. The board anticipates issuing an initial due process document for public comment by the end of 2016. Additional information about the reexamination of the financial reporting model is available on the GASB website. ■

Let Us Hear From You
If you have questions, local firm advocacy issues or suggestions for TIC, contact:

Scot Phillips, CPA
TIC Chair
Email: SPhillips@eidebailly.com

Linda Volkert, CPA
TIC Staff Liaison
E-mail: lvolkert@aicpa.org