The Association of
Accountants and
Financial Professionals
in Business

April 17, 2015

PCC Review
Financial Accounting Foundation
401 Merrit 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Three-Year Review of the Private Company Council

Dear Trustees:

This letter presents the views of the Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) on the Financial Accounting Foundation's (FAF) Request for Comment on its Three-Year Review of the Private Company Council.

The IMA is a global association representing over 75,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org in the Advocacy Activity section under the About IMA tab.

Summary of Our Overall Position

Before responding to the questions raised in the Request for Comment, we would like to present our overall position with respect to generally accepted accounting principles for private companies.

In our December 22, 2011 letter to the FAF regarding the Plan to Establish the Private Company Standards Improvement Council, we supported the goals of reducing cost and complexity. However, we noted in that letter that cost and complexity concerns apply equally to publicly-held companies. Thus, we urged that those reduction efforts apply to all entities and specific relief for private companies should concentrate more on disclosure complexity. Notwithstanding our urging, much of the initial work of the Private Company Council (PCC) has focused on recognition and measurement exceptions for private companies rather than disclosure exceptions.

In our August 23, 2013 letter to the FASB on one of its private company proposed GAAP exceptions (see copy attached), we provided an extended discussion of our reasoning in support the position of there being no differences in recognition and measurement principles for private and public companies. In summary, we believe:

- differences in core recognition and measurement underpinnings dilute GAAP;

- public and private companies should not have different accounting for the same economic transactions;
- we are not convinced that user needs are substantively differentiated to justify different recognition and measurement principles; and
- while intended to address complexity, some of the specific proposals actually add complexity.

These reasons are explained more fully in the attached letter. We continue to hold these views and they have only been reinforced by additional recognition and measurement proposals issued subsequent to the one for which the August 23, 2013 letter was issued. While the Request for Comment indicates that the PCC's "Look-Back Phase" may now be largely or fully completed such that few or no additional private company recognition or measurement proposals will be issued, we believe that any specific decisions made by the Trustees to improve the PCC process moving forward should be in the context of an overall philosophy similar to what we outline in the bullet points above.

Responses to Questions for Comment

1. A primary responsibility of the PCC has been to review and propose GAAP alternatives that will sufficiently address the needs of users of private company financial statements. Do you believe that the PCC has been successful in proposing alternatives within GAAP that address the needs of users of private company financial statements? Please elaborate.

The GAAP alternatives issued to date pursuant to the PCC's mandate have only recently been adopted by affected companies or are yet to be adopted. Thus, it is probably too early in this new environment for there to be a fully informed evaluation of the degree of usage by preparers and whether user needs are being met. We suggest that the FAF consider formally surveying preparers, auditors, and particularly the users of private company financial statements such as bank lending officers in the next year or two to gather more relevant data. In this way a good assessment of costs and benefits can be made. Representatives of IMA are available to work with the FAF to help design such a survey, perform field testing of it, and/or help identify survey participants. Given IMA's diverse membership from both large and small corporations, public and private, as well as public accounting firm personnel and academics, we have many members who could assist with such a survey effort.

We have already seen that many companies that would qualify for use of private company GAAP alternatives choose not to adopt them because they wish to be "IPO ready" in the future and are concerned about possibly having to change their accounting. Thus, many private companies preparing GAAP financial statements do not avail themselves of the alternatives proposed by the PCC. Further, we suspect that some users of private company financial statements may not always understand the differences between private company and pubic company GAAP.

2. Do you believe the PCC's review of areas of existing GAAP that require reconsideration for private companies (referred to as the "look-back" phase) is complete or almost complete? Please elaborate on what will indicate that the look-back phase (for existing GAAP) is complete.

We further interpret the look-back phase requiring a review of existing GAAP as those matters involving either recognition or measurement in the financial statements rather than disclosure matters. Those recognition or measurement matters originally identified as the "low hanging fruit" issues (page 7 of the Request for Comment) have now all been or are being addressed by the PCC or the FASB and we are not aware of any groundswell of support for other basic GAAP issues to be addressed. Nor to the best of our knowledge has the PCC identified any additional significant items at recent meetings. Moreover, as mentioned earlier, we strongly believe it is in the best interests of GAAP as a fundamental notion that recognition and measurement differences be minimized. Thus, we think it should be concluded that the look-back phase has ended.

3. Another key responsibility for the PCC is to serve as FASB's primary advisory body on the appropriate treatment for private companies on issues that the FASB is actively considering. Do you believe that the PCC has been effective in assisting the FASB in its standard-setting process for active projects? Please explain.

According to the Request for Comments, "The PCC works actively and closely with the FASB to provide recommendations for appropriate treatment for private companies on active FASB projects." Further, "The PCC may vote to provide a recommendation to the FASB for appropriate treatment for private companies on active FASB projects." We understand that the PCC has provided a formal comment letter on at least one FASB proposal although that is the exception and comments are typically provided in a less formal manner.

Because most of these communications are within the FAF organization (PCC to FASB and any response in return), it is difficult for us to assess the effectiveness of the PCC in assisting in the FASB's process. As noted in our opening comments, our hope is that much of the input from the PCC perspective can be in the form of making standards less complex and less costly to apply in practice for all companies and not just private companies.

We note that one recommendation in the Three-Year Review is that "… PCC working groups could provide substantive comment letters on proposed FASB standards." Our concern with this idea is that if there are multiple such working groups it is possible that the FASB could receive mixed signals on the views of private companies. Perhaps any such recommendation should add that if there are multiple working groups, the PCC would be required to consider their views and then prepare a summary letter to provide a uniform position.

We are also concerned about what we understand to be a requirement that the FASB specifically address any matters raised by the PCC in a formal comment letter in the basis for conclusions of a final pronouncement. While the FASB should certainly give due consideration to the PCC views, requiring the PCC's views to be addressed in the basis seems to indicate that the FASB must give priority to the reasoning presented by that faction of commentators rather than, say, users, preparers, auditors, or any other informed constituent. As an organization with over 75,000 members, we do not understand why the PCC's arguments must be specifically addressed in the basis for conclusions but not those of other groups such as ours.

4. What improvements, if any, are needed to ensure the PCC is an effective advisory body to the FASB on issues that the FASB is actively considering?

We believe that the most important ingredients for a successful PCC are that it has the right members and that they perform in an effective manner. There is nothing in the Three-Year Review indicating that the Trustees intend evaluations of the PCC members. While this is obviously a sensitive matter, particularly for volunteer members, we believe it should be added to the list of recommendations in a final report.

On a related point, one of the recommendations in the Request for Comment is that PCC members should participate in FASB outreach with private company stakeholders as schedules permit and that the members should develop their own internal networks to gather input. We are somewhat concerned that such a recommendation could lead to different classes of members as some might have more time available and spend a great deal of time so participating and networking while others do the bare minimum. We certainly support well informed PCC members but also suggest that Trustees take care to not cause any individuals to become marginalized in their effectiveness.

5. Since the establishment of the PCC, do you believe that the FASB has been appropriately responsive to the needs of private companies and the recommendations from the PCC?

The impetus for the creation of the PCC was the issue of complexity facing private companies. We have been very impressed with the positive response by the FASB to the PCC. Not only has the Board been fully responsive to both the letter and spirit of the PCC understanding, it has devoted a great deal of attention recently to simplification efforts for all companies. At least some of this came from the realization that particular projects that started as specifically applicable to private companies also should be extended to public companies. But more broadly there is a true understanding these days that GAAP has just become too complex for everyone and we need to push the "easy button." We have long held this belief.

We note that for simplification of accounting for stock compensation, the FASB and PCC are working together to identify ideas for both public and private companies. We strongly agree with this approach.

6. Do you believe that further changes to the standard-setting process for private companies are warranted? Please elaborate.

See comments under Question 9 and elsewhere.

7. Do you have any suggestions regarding changes to the size, composition, term length, or responsibilities of the PCC?

They all seem reasonable to us. Clearly there needs to be rotation starting soon so that fresh thinking begins and all institutional memory is not lost at once.

8. When the Trustees established the PCC in 2012, the Trustees envisioned that their existing Standard-Setting Process Oversight Committee would assume the oversight responsibilities for the PCC after three years. Is there a reason that the Standard-Setting Process Oversight Committee should not assume those responsibilities in 2016?

We agree that it is reasonable for the existing Standard-Setting Process Oversight Committee to assume responsibility for oversight of the PCC in 2016. However, while current Trustees appear to have extensive experience with public company and governmental entity financial reporting, very few of them appear (based solely on their brief bios on the FAF web page) to have extensive experience with private company financial reporting. Combining this activity with the others, therefore, could be seen by some constituents as the Trustee level giving less emphasis to the matter and creating a credibility problem. On the other hand, any lack of expertise at the Trustees would be an issue whether oversight is performed in a separate committee or in the combined one.

9. What is your reaction to the possible improvements included in the prior section?

Other than as mentioned in our responses to a few of the specific questions above, we agree with the Possible Improvements included in the Request for Comments. We particularly support the recommendation dealing with the PCC Agenda. However, we believe the final wording should make clear that the PCC and FASB must agree before a project is added to the PCC's agenda.

10. What other improvement to the PCC or its process would you suggest?

We have no additional suggestions for improvement.

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Thank you for the opportunity to comment on the Three-Year Review of the Private Company Council. If you have any questions about our response, please let me know.

Sincerely,

Nancy J. Schroeder, CPA
Chair, Financial Reporting Committee
Institute of Management Accountants
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The Association of
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August 23, 2013

Financial Accounting Standards Board
Technical Director
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. PCC-13-01A

Dear Ms. Cosper:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to provide its views to the Financial Accounting Standards Board (FASB) and the Private Company Council (PCC) on the proposed standards updates, *Accounting for Identifiable Intangible Assets in a Business Combination*, *Accounting for Goodwill* and *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps* issued on July 1, 2013 (Proposals).

The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Information on the FRC can be found at www.imanet.org under the Advocacy section.

As stated in our letter to the Financial Accounting Foundation dated December 22, 2011 regarding the *Plan to Establish the Private Company Standards Improvement Council*, the concerns raised by private company users, preparers and auditors are real and we support the goals of the Proposals to provide decision-useful information to users and to reduce cost and complexity. We believe that the broad concerns that the Proposals are addressing are equally applicable to publicly held companies, especially considering that the majority of registrants are small and medium size companies. The FASB should fast-track efforts to analyze cost/benefit concerns and reduce complexity for all entities. The scope of the PCC proposals could then be scaled back to focus more on disclosure complexity.

We do not favor the Proposals in the context of a separate set of standards that result in different recognition and measurement principles for privately held companies for the following reasons.

- We believe differences in the core recognition and measurement underpinnings for public and private companies dilute US Generally Accepted Accounting Principles (GAAP).
- We do not believe public and private companies should have different accounting for the same economic transactions.

- We are not convinced that user needs are substantively differentiated to justify the different recognition and measurement principles.
- We believe the Proposals address complexity by adding complexity.

Further, we believe that the Proposals are premature and the comment periods are too short. The paragraphs below address our concerns in more detail.

One GAAP

The FASB has proven over time to have an inclusive and transparent process for standard setting. We believe this process represents the gold standard and produces the highest quality standards for accounting and financial reporting. Over its forty-year history, the FASB has rarely permitted alternatives and, in fact, when reconsidering topics has eliminated alternatives. By and large, the financial reporting standards issued by the FASB are based on the best recognition and measurement treatment for a transaction, resulting in one set of GAAP for all companies or within one industry.

Permitting alternatives under GAAP has negative long-term consequences for financial reporting in the US. The FASB must continue to impose a high hurdle for recognition and measurement differences and operate with a presumption of universal application recognition and measurement for the same economic transactions. While public companies represent a very significant economic segment of entities utilizing US GAAP, the overwhelming majority of entities that are covered by the scope of US GAAP are small to medium sized non-public entities. Private companies are the majority of companies, not the exception. Is it appropriate for the majority of entities to have the option to use alternatives under GAAP? We think no.

To illustrate the consequences of the direction these Proposals and the recently endorsed PCC proposal on *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements* are heading, assume a private company has goodwill, a purchased non-contractual intangible asset, an interest rate swap hedging floating rate debt and a leasing variable interest entity. Also assume that the FASB finalizes the four PCC proposals which permit a choice of existing GAAP and the allowed alternative(s).

Without considering the choice of two alternatives for interest rate swaps, this private company would have a free choice to prepare its financial statements in at least 16 potentially material different ways assuming that each choice of the accounting policies for each of the four financial statement items is independent of the other choices. The company could get a clean opinion from its auditor on any of the 16 ways. The auditor's opinion would say the financial statements conform to "GAAP"—not "GAAP for private companies".

Same Economics, Same Accounting

We believe that the FASB must continue its gold standard process by first addressing the similarity rather than the differences for private versus public entities. If the economics of a transaction are the same for a private company as they are for a public company, then the measurement and recognition under GAAP should be the same. Optimal recognition and measurement guidance is guidance that can be universally applied in a cost effective manner to transactions with the same economics or within the same industry. Is it appropriate to have four different ways to account for simple interest rate swaps that convert variable rate debt to fixed rate debt? We do not think so. The "man on the street" cannot understand why there is different accounting for exactly the same transaction based on whether or not the user can talk to management or for any other reason.

Offering simpler and easier alternatives to one group of entities for exactly the same transaction is the equivalent of lowering the grading curve so that everyone gets an "A". We all know what happens to the value of a degree from that institution. It is not acceptable to reduce the standards for the majority of companies in the US.

There are other comprehensive bases of accounting, such as tax basis or cash basis, to address simpler and easier accounting treatment. Members of the FRC have found that it is not uncommon for private company investors to accept via operating agreements only tax basis financial statements.

Users' Needs

GAAP is intended to produce general purpose (not special purpose) financial statements that meet the needs of a very broad cross section of users. Our experience is that users of financial statements have the same goals and thus are interested in the same information and metrics. Fundamentally, users of both private and public entities need information to predict future cash flows. The lending and investing decisions are the same for a large multinational private company and a large multinational public company.

If the PCC has a solid body of evidence indicating that some aspect of financial reporting is not useful or relevant to users of private company financial statements or that the standard is too complex, the FASB has an obligation to understand whether that is equally true for users of public company financial statements. In short, when the PCC points out a shortcoming in existing GAAP, the FASB has an obligation to understand why its original research, analysis, outreach and conclusions may have been mistaken or become outdated. For example, did the results of the post implementation review for business combination accounting indicate cost/benefit issues? Did the feedback indicate a difference for public and private companies?

Lending agreements provide another example. Given that tangible net worth covenant tests are the same for both public and private companies, goodwill and identifiable intangibles are logically equally as relevant or equally irrelevant to credit officers. Dialog that members of the FRC from lending institutions have had with the credit departments of their organizations suggests that the credit analysis would require consistent accounting for all entities and would require submission of financial data without alternative treatment. This may limit private company use of the alternatives in the Proposals.

If the FASB finds a significant difference in the needs of users of private company financial statements because of access to management, the FASB should start with differential disclosure. It is logical that the level of information disclosed might vary due to access to management, but not the recognition and measurement. We have some experience with limited disclosure for private companies versus public companies already. Consider segment disclosures and other incremental disclosure received by public company users via SEC regulations.

Addressing Complexity by Adding Complexity

The Proposals assert to be solving complexity problems for both users and preparers. However, these updates perpetuate these problems that they are intended to solve. Recognition and measurement complexity is an issue for **all companies**, including public companies. The only meaningful difference among companies is the ability of larger companies to divert resources to address accounting complexity. There is nothing necessarily right about that resource diversion. In fact, it is easy to argue that unnecessary complexity is wrong and a waste of shareholder value and not useful to users.

Alternative accounting treatments add complexity, confusion and cost to the system by:

- diminishing and frustrating comparability,
- adding to the cost of restatements for entities going public or maintaining two sets of books for the no alternative requirements of lending covenants, and
- adding the cost of initial and continuing education (and licensure) of the alternative accounting for auditors, users and preparers.

Optimal answers are not always the most complex. Frequently, simple, intuitive solutions prove the most cost-effective decision usefulness over time.

Premature

Let's walk before we run. The PCC and FASB have jumped into fundamental recognition and measurement before finalizing a private company framework or the definition of a public company.

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Limited Comment Periods

The FASB has not allowed long enough comment periods for such fundamental changes to US GAAP. These important issues require thoughtful evaluation and meaningful input from a broad spectrum of constituents. There seems to be a rush to judgment with an artificial deadline. Parties affected by the proposed updates include:

- private company preparers,
- auditors of private and public companies,
- users including bank lending officers, commercial company credit departments and insurance companies, and
- public company preparers through the potential extension of the proposals to all entities.

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We would be pleased to discuss these comments with you at your convenience.

Sincerely,

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Institute of Management Accountants
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