AICPA PCPS Private Companies Practice Section

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July 16, 2014

Susan M. Cosper, CPA
Technical Director
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Re: March 4, 2014 Exposure Draft of a Proposed Statement of Financial Accounting Concepts, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements* [File Reference No. 2014-200]

Dear Ms. Cosper:

One of the objectives that the Council of the American Institute of Certified Public Accountants (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 ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC is generally supportive of the ED and noted that it includes a number of improvements over the 2012 Invitation to Comment (ITC), *Disclosure Framework*. TIC appreciates:

- The paragraphs that were added to describe the purpose and objectives of notes to financial statements and the types of information that would be considered appropriate and not appropriate for inclusion in the notes.

- The exclusion of employee benefit plan disclosures from the scope of the proposed chapter.

- The modifications made to the future-oriented decision questions.

TIC believes the ED strikes an appropriate balance between the need for relevant disclosures and the limitations on disclosure posed by excessive cost or potential negative consequences to the entity. While TIC understands that disclosure effectiveness is the Board's key objective, TIC is also hopeful that disclosure reduction can be a byproduct of this disclosure framework.

However, TIC does not support the disclosure of alternative measurements and recommends that decision question L15 be deleted, or, if retained, that its scope be limited to those situations where clear benefits to financial statement users can be demonstrated. In addition, questions L3 and L5 and paragraph D10 should be revised to clarify the Board's intent.

TIC is also requesting that Chapter 8 include specific reference to the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (the private company framework) and its interrelationship with this ED.

SPECIFIC COMMENTS

Question 1: *Should financial statements of employee benefit plans be excluded from the scope of this chapter of the conceptual framework?*

Yes, the financial statements of employee benefit plans should be excluded. The primary readers of employee benefit plan financial statements are participants and plan sponsors, and the financial statements are not used as part of the decision process for providing resources to the plan.

Question 2: *Do the concepts in this chapter related to not-for-profit entities address the information needs of resource providers to those entities?*

Yes, the concepts appropriately address the needs of resource providers to not-for-profit (NFP) entities, including the needs of contributors, but would benefit from some clarification.

TIC understands that the primary objective of this ED is to improve disclosure effectiveness in the standard-setting process for all entities. TIC also agrees that improving disclosure effectiveness for NFPs in particular means providing users with sufficient information to assess future cash flows and management's ability to deploy its resources efficiently and effectively. However, TIC believes disclosure overload in NFP financial statements is a significant problem and encourages the Board to balance the objectives above with the need for disclosure relief.

TIC also believes that paragraph D10 fails to clearly identify the interrelationship between the information needs of contributors and investors, lenders and other creditors and how that relationship would affect the selection of appropriate disclosures for NFPs. The second sentence of the paragraph does not seem to follow logically from the first sentence. As a result, TIC was uncertain whether contributors are viewed as the primary financial statement users or whether contributors are on equal footing with investors, lenders and other creditors of NFP entities. Paragraph D10 acknowledges that some disclosures may not be beneficial to both contributors and investors, lenders and other creditors but does not provide enough guidance to explain the actions that the Board would be expected to take if a disclosure was relevant to one group but not the other. TIC recommends that paragraph D10 be revised to clarify how the Board would set disclosure requirements when the information needs of these stakeholder groups differ.

Question 3: *Do the concepts in this chapter encompass the information appropriate for disclosure in notes to financial statements that would assist resource providers in their decision making? Are there concepts that should be added or removed?*

Yes, the concepts in this chapter will assist the resource providers in their decision-making process. The ED addresses the issues raised in TIC's December 19, 2012 comment letter on the July 12, 2012 FASB Invitation to Comment, *Disclosure Framework*, as to the lack of objectives for the notes and the need for boundaries around the decision-making process related to note disclosure.

Previously, TIC believed that the concepts were too broad-based and forward looking. The new section (paragraphs D16-D31), which addresses the Limitation on Information in Notes to Financial Statements, is a helpful addition to Chapter 8.

Paragraph BC17 discusses the interrelationship between this ED and the private company framework. TIC believes this information is too important to be placed only in the Basis for Conclusions and recommends that it be moved into Chapter 8 after paragraph D11.

Question 4: *Are there additional concepts needed to identify information that is unsuitable for requirement by the Board in notes to financial statements even though that information would be consistent with purpose of the notes?*

TIC believes there are no additional concepts that would be needed to identify information that would be unsuitable as a requirement in the notes even though that information would be consistent with the purpose of the notes.

Question 5: *Do the decision questions in Appendix A identify the information appropriate for the Board to consider requiring for disclosure when setting standards related to line items and other past events and current circumstances and conditions that can assist resource providers in their decision making?*

Yes, most of the decision questions identify information appropriate for the Board's consideration. However, TIC noted the following exceptions:

Question L3 asks whether the existence or ownership of the rights and obligations underlying the line item could be uncertain. Although the narrative for this question explains that it is different from the uncertainty question related to measurement in Question L9, the nature of the uncertainty that is intended to be within the scope of this question is not adequately distinguished from uncertainties that are already addressed by existing standards. For example, the following situations would seem to meet the definition in Question L3 but would be covered by FASB *Accounting Standards Codification™* (ASC) Topic 450-20 (Loss Contingencies):

- assets held in a foreign country that are under threat of being seized by the foreign government
- a company that's being sued over its rights to certain assets.

In addition, TIC could not discern a clear distinction between "uncertainty about whether an asset or liability exists or is owned or owed by the entity" and "uncertainty about outcomes." Uncertainties about the existence or ownership of an asset usually involve an uncertainty about outcomes.

TIC therefore recommends that the Board clarify this decision question and provide examples of when the Board would consider this question in determining the need for disclosure requirements. For example, the narrative explaining the question should emphasize that it would apply to an existing line item in the financial statements and not an uncertainty about initial recognition of an asset or liability. If this decision question is not expected to be used on a regular basis, this should also be indicated in the narrative.

Question L5 asks:

Are the cash flows related to the line item subject to change as a result of changes in general economic conditions or market factors? If so, are the specific conditions or factors or the nature of their effects not apparent from the description of the line item?

TIC believes the scope of this question is too broad and should specify that the anticipated change in the cash flows related to the line item would have to be potentially significant to warrant disclosure. Although this is implied in item (a) under the Information Considered for Disclosure, TIC suggests that this provision be included in the decision question.

Also, the types of changes listed in Item (a) seem inconsistent with the statement that the changes or their effect would not be apparent from the description of the line item. Most, if not all, of the examples given would have obvious effects on a line item.

The examples in paragraph D30 and Question L5, footnote 14, relate primarily to a public company environment. TIC recommends that the Board re-examine this question from the perspective of private entities and include a private company example.

Question L15 asks whether there is an alternative measure or way of applying a measurement that clearly would be useful in assessing prospects for cash flows. TIC believes this decision question is too far-reaching in scope. It implies that any alternative measure for any line item could be a candidate for disclosure.

TIC believes disclosure of multiple measurement options and the magnitude of the difference between the reported measurement and the alternative measurement(s) would be confusing to financial statement users. Many financial statement users would not understand why one measurement was selected over another or how to use this information to assess the prospects for cash flows. Management selects the most relevant measurement option (where measurement options are provided) for the financial statement user and provides GAAP disclosures relating to that measurement. There would be little reason (if any) to expand disclosures to other measurement options.

The proposed decision question is also unclear as to its effect on private entities that elect to adopt an accounting measurement alternative approved by the FASB and the Private Company Council (PCC). TIC was uncertain whether a presumption exists that use of a PCC alternative should be accompanied by disclosures about the measurement that would normally be required if the PCC alternative did not exist.

Paragraph BC8 in the ED, which attempted to clarify the Board's rationale for retaining the decision question on the disclosure of alternative measurements, was unconvincing. The limited circumstances where disclosure of alternative measures would be "useful and appropriate" do not outweigh the circumstances where such disclosure would be ignored by, or would be confusing to, financial statement users.

TIC therefore recommends that this decision question be deleted from the Appendix, or, if retained, that its scope be narrowed considerably to apply only to the specific circumstances (such as the LIFO conformity rule and the disclosure of a LIFO reserve) where it would be useful. In addition, the final standard should clarify how the decision question would apply, if at all, to measurement alternatives when the preparer has elected to use any available PCC measurement alternatives.

Question 6: *Does the discussion in paragraphs D43-D50 identify the information appropriate for the Board to consider when setting standards related to information about the reporting entity?*

Yes, paragraphs D43-D50 contain appropriate information for the Board to consider when setting standards for disclosures relating to various aspects of the reporting entity.

Question 7: *Will the concepts related to future-oriented information (paragraphs D22-D31) result in disclosures that are appropriate for the notes? If not, what types of information should be included in or excluded from consideration for disclosure in the notes?*

Paragraph D31 states that the Board generally does not require disclosures of expectations and assumptions about the future that are not inputs to current measures in financial statements or notes. Paragraph D25 of the ED also emphasizes that the Board will not require entities to disclose in notes the types of future-oriented information with "the greatest potential for negative consequences" to a reporting entity. Paragraph D23 cites some examples of negative consequences, including litigation or threat of litigation and loss of credibility that could occur when future-oriented disclosures predict events or conditions that are significantly different from the actual results, when known. Paragraph D17 states that negative effects on the cash flow prospects of the reporting entity and its investors and creditors would be another type of negative consequence. To enhance the clarity of the framework, TIC recommends that all of the perceived "negative consequences" be repeated in paragraph D31.

Question 8: *Do the concepts in this chapter appropriately distinguish the types of information that are appropriate for the notes from the analysis management provides in other communications?*

Some notes will inevitably overlap with management analysis provided in other communications since historical financial information and disclosures are the basis for determining any risk factors, management discussions and analysis. "Other communications" for private entities can include a president's letter at the beginning of an annual report or a management's-discussion-and-analysis-type narrative in the annual report of a NFP entity. TIC believes the concepts in this ED provide adequate guidance as to the identification of types of information that are appropriate for the notes from the management analysis provided elsewhere.

Question 9: *Are the concepts related to disclosure requirements for interim periods (paragraphs D60-D71) appropriate? If not, are there concepts that should be added or removed?*

In its 2012 comment letter on the *Decision Framework* ITC, TIC stated that it did not support the development of a separate decision framework for interim financial statements. TIC reaffirms its previous comment and agrees that the concepts in the ED related to interim disclosures are appropriate.

Question 10: *If no disclosure guidance for a transaction, event, or line item is specified in U.S. GAAP, how will an entity consider the nonauthoritative guidance in this chapter?*

If no disclosure guidance is specified in U.S. GAAP, the entity should always consider the needs of resource providers. Concepts included in the chapters and the decision questions in Appendix A should be considered when determining disclosure in accordance with paragraphs 105-10-05-2 and 05-3 of the FASB ASC, as discussed in the Preface (paragraph P10) to the ED.

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,

Scot Phillips

Scot Phillips, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees