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VIA EMAIL TO: Director@FASB.org

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: PCC Issue No. 13-01A, *Accounting for Identifiable Assets in a Business Combination*

Mr. Golden and the Members of the Board:

We are both puzzled and concerned by a recent decision of the Private Company Council (PCC) on PCC Issue No. 13-01A, *Accounting for Identifiable Intangible Assets in a Business Combination*.

EY, in its report on the September 16, 2014 meeting of the PCC,[1] reports the following:

> "The PCC clarified that an intangible asset arising from a favorable off-market component of a customer-related contract (i.e., a component that would give the entity better-than-market rates) would be in the scope of this alternative and generally wouldn't be recognized separately. However, a liability arising from an unfavorable off-market component of a customer-related contract (i.e., one that would give the entity worse-than-market rates) still would be recognized separately as a liability."

Assuming this and other similar reports of the PCC's decision are correct, the PCC's proposal both puzzles and concerns us.

- We are puzzled because the PCC's decision seems to offer preparers of financial statements no significant cost savings compared to existing U.S. GAAP, an outcome that appears inconsistent

[1] See EY's publication *To the Point*, No. 2014-35, 18 September 2014. Although we have opted to quote EY's publication, we note that other major accounting firms report similar information.

with the PCC's Decision-Making Framework.[2] Consistent with the requirements of existing U.S. GAAP, customer-related contracts will still need to be identified and their terms analyzed as to whether they are favorable or unfavorable compared to current market conditions. Furthermore, unfavorable customer-related contracts will continue to require separate valuation. The only task that would be eliminated is the actual valuation of the favorable customer-related contracts, a task that does not appear overly burdensome once the contracts' terms have been determined, based on evidence of current market conditions, to be either at-market or above market. Furthermore, the staff's own analysis suggests that "for most companies and in most industries, favorable and unfavorable customer contracts are fairly uncommon."[3] Thus, the PCC is apparently seeking to create a departure from existing U.S. GAAP that would provide very little cost savings to very few companies in very few industries.

- We are concerned because the resulting financial reporting is biased, an outcome that is inconsistent with the FASB's stated goal of neutrality in the establishment of accounting standards for financial reporting.[4] Specifically, we believe that embedding favorable contracts in goodwill and separately recording unfavorable contracts as liabilities will generally result in the overstatement of income. Assuming that most favorable customer-related contracts have much shorter lives than 10 years (the default amortization period for goodwill), income will be overstated in periods immediately following the business combination. At the same time, the acquirer will have recorded a liability for unfavorable customer-related contracts such that the "negative" effects of those contracts will not depress post-acquisition earnings. The staff's outreach to stakeholders indicated that "users were generally interested in the recognition of loss-making or onerous contracts" because "information on these liabilities was useful in understanding the business combination."[5] However, this observation does not address the equally important question of whether users would be concerned by the income statement consequences of recording liabilities for unfavorable contracts while effectively ignoring assets for favorable ones.

In short, we do not see how the PCC's decision on customer-related contracts is consistent with either the PCC's guidelines for evaluating financial reporting for private companies or the FASB's guidelines for setting accounting standards for general purpose financial statements. Any reduction in costs of preparing financial statements under this proposal appear minimal, at best, while the biased financial reporting consequences would seem troublesome to users, regardless of whether those users have access to management.

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[2] As stated in paragraph BC7 of the *Private Company Decision-Making Framework*, "… the PCC should evaluate … different considerations … by emphasizing that it is most important to focus on providing relevant information to financial statement users… [T]he PCC should place a significant, albeit lesser, focus on considerations about the cost and complexity of providing that relevant information."

[3] Paragraph 22 of PCC Issue 13-01A Issue Summary No. 1, Supplement No. 8 dated September 5, 2014. See also paragraph 25(a) of that same issues paper.

[4] "Neutrality in accounting is an important criterion by which to judge accounting policies, for information that is not neutral loses credibility … To be neutral, accounting information must report economic activity as faithfully as possible, without coloring the image it communicates for the purpose of influencing behavior in some particular direction." (paragraphs 107 and 100, FASB Statement of Concepts No. 2, *Qualitative Characteristics of Accounting Information*)

[5] Paragraph 23 of PCC Issue 13-01A Issue Summary No. 1, Supplement No. 8 dated September 5, 2014.

There are other aspects of the PCC's decisions on this project that concern us. However, we believe this specific outcome represents a fatal flaw. We recommend that the Board not endorse the PCC decision on this issue.

If you have any questions, please contact John Stewart at 312-345-9104 or Amy Ripepi at 312-345-9103.

Sincerely,

Financial Reporting Advisors, LLC

Financial Reporting Advisors, LLC

cc: Ms. Susan M. Kosper, Technical Director