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Private Company Accounting Relief Projects Move Forward

The Private Company Council (PCC) is a FASB advisory body for private company accounting matters and helps develop GAAP alternatives to meet the unique needs of users of private company financial statements. The PCC recently approved projects for credit losses on accounts receivables and the presentation of retainage. Research updates were provided on potential relief for debt modifications and leases.

Credit Losses on Accounts Receivable

For many private companies, applying Accounting Standards Codification (ASC) 326, *Financial Instruments—Credit Losses* (CECL), to short-term trade receivables is time-consuming and results in minor change in credit loss provisions. Feedback from private companies as part of the post-implementation review (PIR) process has highlighted that certain CECL principles may be operationally burdensome to apply or difficult to understand when financial assets have limited loss experience and are short term in nature, *e.g.*, adjusting historical loss experience for current conditions and reasonable and supportable forecasts. The PCC approved the drafting of a proposal scheduled for issuance in late December or early January. Proposal highlights include:

Scope. The proposal will cover current accounts receivables and contract assets arising from transactions accounted for under ASC 606, *Revenue from Contracts with Customers*. This would exclude receivables accounted for under other accounting guidance, *e.g.*, ASC 610-20, *Gains and Losses from the Derecognition of Nonfinancial Assets*.

Practical expedient. The proposal would create a new practical expedient permitting a private company to assume that current economic conditions as of the balance sheet date persist throughout the forecast period.

Accounting policy election. If the practical expedient is elected, an accounting policy election would allow a private company to consider collection activity after the balance sheet date but before the financial statements are available to be issued to inform the credit loss allowance. A private company could record a zero-credit loss allowance if all outstanding receivables have been collected before financial statement issuance.

The meeting materials highlighted the following sequence in applying these accounting alternatives:

Step 1: Subsequent Collection Activity Election: A private company should first consider subsequent collection activity in the development of the reasonable and supportable forecast associated with the related credit loss allowance determination. No credit loss allowance would be expected for balances collected in full before the reporting date.

Step 2: Practical Expedient for Remaining (Uncollected) Balances: After considering collections after the balance sheet date, a company would then evaluate any remaining uncollected balances as of the reporting date, including aging of the uncollected receivables between the balance sheet and the reporting date. Using the practical expedient, the company would assume current conditions as of the balance sheet date exist through the forecast period.

> The consideration of collection activity after the balance sheet date does not affect the company's recognition of subsequent events activity under ASC 855, *Subsequent Events.* It only allows a private company to use this information to inform its estimate of credit losses at the balance sheet date.

Effective date and transition. Adoption would be on a prospective basis and early adoption would be permitted upon issuance and before financial statements are available for issuance. Similar to the existing private company elections, there would be no effective date, and a private company could adopt at any time without demonstrating preferability.

Tentative Project Time Frame

Presentation of Retainage & Overbillings

In the construction industry, contracts often contain retainage provisions, which allow a customer to withhold a portion of invoice billings (usually in an escrow account) until certain project milestones are met or the project is completed.

Before the adoption of ASC 606, industry practice was to present conditional retainage separately from billings in excess of costs (deferred revenue). Under ASC 606, retainage may be classified as a contract asset or as a receivable, depending on whether the payment is conditioned on the entity's future performance. If the retainage is determined to be a contract asset, it must be netted with contract liabilities within the same contract for financial statement presentation. Some companies are voluntarily disclosing gross amounts in financial statement notes for surety companies, but under ASC 606, they are precluded from breaking out the amounts on the face of the financials. The surety industry has lobbied for easier-to-find, decision-useful information on gross retainage amounts to accurately assess risk.

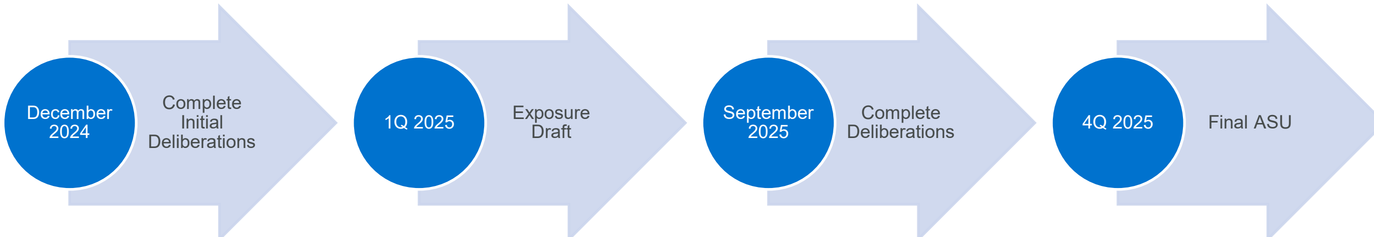
In September, the PCC added a project to its agenda and approved the drafting of an exposure draft. Proposal highlights include:

Scope. The accounting alternative would be limited to private construction contractors covered by ASC 910-10, *Contractors-Construction.*

Private company alternative. An in-scope private company would be allowed to separately present contract assets and contract liabilities on a gross basis on the balance sheet for all of a company's contracts with customers. If elected, this would be applied entitywide to all of a company's contracts and not on a contract-by-contract basis.

Transition. Adoption would be on a full retrospective basis. Private companies in the construction industry would be required to present the amount of each contract's conditional retainage/contract assets and overbilling/contract liabilities on a gross basis in the financial statements.

Tentative Project Time Frame



Debt Modifications

Guidance in ASC 470-50, *Debt—Modifications and Extinguishments*, is complex to understand and costly to apply, especially for transactions with multiple lenders. For private companies, the costs may exceed the benefits.

Under ASC 470-50, an issuer of loans or debt instruments must assess whether the exchange results in debt terms that are "substantially different" (or results in a "substantial modification" if the debt is modified rather than exchanged). An exchange or modification is considered substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10% different from the present value of the remaining cash flows under the original instrument's terms. Many financial statement preparers find this "10% cash flow test" to be arbitrary and difficult to understand. Depending on the outcome of the 10% test, different accounting is required. A different assessment is required for lines of credit and revolving debt arrangements.

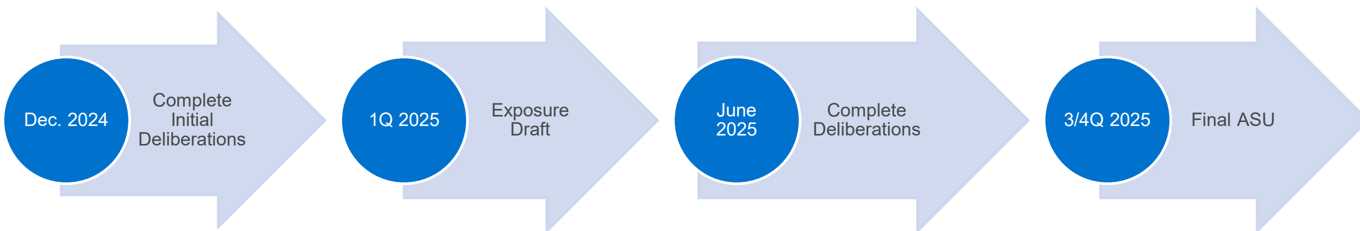
Since this guidance was first issued in 1996, FASB has received feedback on the operational challenges and costs to apply. FASB considered various projects to address concerns in the past, but the board was unable to reach a consensus on a solution.

Potential solutions that are currently being researched include:

- Account for all debt exchanges and modifications as debt extinguishments. A private company could elect an accounting policy to account for all the transactions as debt extinguishments.
- Account for all debt exchanges and modifications as debt modifications. A private company could elect an accounting policy to account for all the transactions as debt modifications.
- Permit the use of a qualitative assessment. A private company could elect to apply a qualitative assessment instead of (or before performing) the quantitative assessment in ASC 470-50.
- Perform the quantitative assessment at the instrument level. A private company entity would be permitted to perform the quantitative assessment based on the total cash flows of the instrument instead of performing the assessment for each lender.

At the September PCC meeting, staff provided an update on additional outreach with four private company financial statement users on the approaches noted above.

Tentative Project Time Frame



Leases

Although ASC 842, *Leases*, provides multiple practical expedients and accounting elections, the project's PIR process revealed stakeholders supported additional relief for certain areas that are costly and complex to apply, including:

- Determining the incremental borrowing rate
- Identifying leases, including those in nonlease contracts (embedded leases)
- Lease modifications
- Lessee allocation of fixed and variable payments to lease and nonlease components
- Lease classification test

A working group has now been established to identify the most challenging guidance to apply, and which simplifications would be most helpful for private companies, starting with the list above.

Tentative Project Time Frame

Conclusion

The assurance team at Forvis Mazars delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. Whether you are publicly traded or privately held, Forvis Mazars can help provide an independent and objective view into your financial reporting. We leverage some of the latest technologies and process automation tools to provide companies assurance on their financial statements to help meet stakeholders' needs.

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