



September 7, 2010

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VIA EMAIL

Re: **Proposed Accounting Standards Update, “Fair Value Measurement and Disclosure (Topic 820),” issued June 29, 2010. File Reference 1830-100.**

INTRODUCTION

The National Venture Capital Association (NVCA) is pleased to comment on the above referenced proposed Accounting Standards Update, Fair Value Measurement and Disclosure (Topic 820), (hereinafter, “the Proposed ASU”). NVCA represents the vast majority of American venture capital under management.¹ NVCA member firms and the funds they manage provide the start-up and development funding for innovative entrepreneurial businesses.

NVCA’s comments are informed by the active input of its CFO Task Force. This group is made up of the Chief Financial Officers and Administrative Partners of more than 100 of our member firms. With guidance from the CFO Task Force, NVCA has worked with the FASB throughout the development of the fair value measurement standard. We support the FASB’s ongoing efforts to converge this standard with the IFRS fair value measurement standard in a way that preserves the many nuanced aspects that have been built into the GAAP standard over this prolonged period of development.

¹ The National Venture Capital Association (NVCA) represents more than 400 venture capital firms – 90% of the venture industry. NVCA’s mission is to foster greater understanding of the importance of venture capital to the U.S. economy and support entrepreneurial activity and innovation. NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provide reliable industry data, sponsor professional development, and facilitate interaction among its members. For more information about the NVCA, please visit www.nvca.org.

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BACKGROUND AND GENERAL COMMENTS

Venture capital funds (“VCFs”) are primarily made up of assets that are valued based on Level 3 inputs. VCFs calculate the value of fund assets according to the framework set out in Topic 820, in accordance with Investment Company GAAP set out in Topic 946. Virtually all independent venture capital funds have been reporting under the *AICPA Audit and Accounting Guide: Investment Companies* for decades. As entities that are required to report using fair value, venture capital funds have an intense interest in ensuring that the Proposed ASU requires practical fair value reporting on Level 3 assets.

Our comments are intended to support the FASB in its ongoing effort to arrive at a single high quality and global standard on fair value measurement. This Proposed ASU, subject to the specific comments below, is a good step toward that goal. Most of our comments relate to the need to retain the appropriate level of discretion for preparers to apply judgment under the basic principles of fair value measurement. Such discretion is essential if venture capital fund financial statements are to deliver decision-useful information to their investors in a cost-effective manner.

SPECIFIC COMMENTS

1. Measurement Uncertainty (Sensitivity) Analysis

ISSUE

ED Question 7: *“The Board has decided to require a reporting entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for recurring fair value measurements categorized within Level 3 of the fair value hierarchy unless another Topic specifies that such a disclosure is not required for a particular asset or liability (for example, the Board has decided in its project on the accounting for financial instruments that a measurement uncertainty analysis disclosure would not be required for investments in unquoted equity instruments). Do you think that proposal is appropriate? If not, why not?”*

COMMENTS

Quantitative uncertainty analysis regarding venture capital assets is not useful for investors.

The 2009 FASB exposure draft, *Proposed Accounting Standards Update, “Fair Value Measurement and Disclosure (Topic 820)”*,² framed the question of the cost and benefits of Measurement Uncertainty or Sensitivity Analysis well. NVCA’s comment letter,³ filed October

² *Proposed Accounting Standards Update, “Fair Value Measurement and Disclosure (Topic 820)”*, issued August 28, 2009, (File Reference No. 1710-100).

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8, 2009 sets out our views on the impact that a requirement for such disclosure would have on VCF financial reporting. In summary, we do not believe such analysis provides decision-useful information regarding venture capital assets. We believe our comments were heard, and that we helped the FASB reach the conclusion to appropriately exclude “unquoted equities instruments” from such a disclosure requirement in the project on Financial Instruments. Therefore, we will not reiterate them here.

We believe exemption for unquoted equities from measurement uncertainty analysis is highly appropriate and should be expanded slightly.

We believe the Board made the correct cost-benefit decision regarding “unquoted equity instruments” and measurement uncertainty analysis. However, we urge the Board to take the next logical step and remove the requirement to disclose measurement uncertainty for certain level 3 debt instruments.

We recognize that at least one goal of this new disclosure requirement is to provide investors with information regarding debt instruments that were once actively traded but are no longer. Therefore, our recommendation is that the exemption from measurement uncertainty analysis be expanded slightly to include unrated debt instruments that were issued by a private company. We believe this to be a small number of debt instruments. VCFs may hold debt instruments in private companies as part of their investment portfolios. This type of debt is primarily valued based on an analysis of the underlying value of the issuer and its ability to repay the debt and is not subject to the type of matrix pricing commonly used for rated debt instruments for which measurement uncertainty analysis might be meaningful.

The exception for unquoted securities should be dealt with outside of the project on Financial Instruments.

We recommend that the FASB establish the exception for unquoted securities at this time and outside of the project on Financial Instruments. Our reasons are practical. First, there is no certainty that the exception will be in the final Financial Instruments standard and, second, it is unclear when the Financial Instruments standard will go into effect. Therefore, the exception should be incorporated into the new Fair Value Measurement (“FVM”) standard, or some other standard that will be effective on the same timetable. If the Board believes that measurement uncertainty analysis is not cost-effective for level 3 unquoted assets, VCFs should be clearly exempted before any such general requirement regarding fair value disclosure goes into effect.

³ Comment Letter of the National Venture Capital Association, October 8, 2009, re *Proposed Accounting Standards Update, “Fair Value Measurement and Disclosure (Topic 820),”* issued August 28, 2009, (File Reference 1710-100), available at <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819777697&blobheader=application%2Fpdf>.

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The Proposed ASU may indirectly impose an uncertainty analysis disclosure requirement on venture capital funds.

The Proposed ASU presents a new problem with regard to the need to develop measurement uncertainty analysis information. The “Measurement Uncertainty” table at p. 114 of the Proposed ASU lists “Private Equity Investments,” “Venture Capital Investments,” and “Hedge Fund investments,” as examples of investments needing such disclosure. Applying the sample table to venture capital investments suggests that VCF limited partners would need to provide a range of values around the net asset value (“NAV”) reported by its fund general partner (“GP”). If the FASB intends this new requirement, the fund investors will have as much or more difficulty assigning meaningful variations as would a VCF. As we noted in our October, 2009 comment letter:

Changes in the value of these [venture capital] assets occur episodically. They are usually determined by an outcome or an event. A company’s value can rise or fall dramatically if, for example, the FDA approves trials for a new drug or not, a prototype product works or doesn’t, the market reacts well to a new idea or not, or a large competitor works with the start-up or against it. In this regard, variations in value are often binary. The outcomes do not slide along a continuum based on assumptions about external factors like interest rates or variations in multiples. Rather alternative assumptions are often simply opposite ends of the spectrum, with success (the product or idea continues to advance) at one end and failure (time to wind down the company) at the other. Therefore, while useful for other securities, sensitivity analysis will not provide meaningful information regarding most VCF assets.⁴

We cannot speak for the large and varied community of venture capital limited partners with reporting obligations. However, we must anticipate that, faced with a requirement to make measurement uncertainty disclosures, they would look to their fund GPs for such information. Thus, the wise cost-benefit decision that the Board has made regarding unquoted instruments would be nullified indirectly.

We hope that the suggestion in the sample “Measurement Uncertainty” table is inadvertent. If it is not, we strongly urge the FASB to reconsider this requirement and extend the exemption for unquoted instruments to encompass interests in funds that report values at NAV, based on the preponderance of unquoted instruments in the fund.

Effective alternatives to quantitative measurement uncertainty disclosures are already in use.

We believe that the current types of qualitative disclosures that are typical for venture capital funds address measurement uncertainty and the need for additional disclosure is unnecessary. NVCA’s October 8, 2009 comment letter includes an example of the type of disclosure that VCFs currently make regarding the values determined for VCF assets.

⁴ Id. p. 3.

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Level III – Pricing inputs are unobservable and include situations where there is little, if any, market activity for the investment. Fair value for these investments are estimated by the General Partner using valuation methodologies that consider a range of factors, including but not limited to the price at which the investment was acquired, the nature of the investment, local market conditions, trading values on public exchanges for comparable securities, current and projected operating performance, financial condition and financing transactions subsequent to the acquisition of the investment. The inputs into the determination of fair value require significant judgment by the General Partner. Due to the inherent uncertainty of these estimates, these values may differ materially from the values that would have been used had a ready market for these investments existed. Investments that are included in this category generally are privately held debt and equity securities which represent approximately XX% of partners' capital.⁵

ED Question 11: “Should any of the proposed amendments be different for non-public entities?”

As a general matter, investors in private entities, including investors in venture capital funds, have access to far more information than that contained in the entity's financial statements. Unlike public company investors, they have direct access to the GP, fund managers and may have access to the books and records of the entity upon request. In addition, the sophisticated investors that provide the vast bulk of venture capital already have considerable influence on venture capital valuation and reporting practices. Funds and their limited partners participate in an ongoing dialogue on ways to improve financial reporting. If venture capital investors should find some type of measurement uncertainty analysis meaningful to them as either users or preparers of financial statements, the industry will adopt a cost-effective means of disclosing it. A quantitative range of possible measurement values for level 3 investments such as venture capital with highly subjective valuations does not provide decision useful information for the users of financial statements. The cost of preparing and auditing a quantitative measurement uncertainty analysis would be very high relative to the value of such information. Therefore, we believe that the FASB should exempt private entities, at least, from any new measurement uncertainty disclosures regarding unquoted equity and unrated debt instruments. Imposing the same disclosure requirements for Level 3 venture capital assets that may be appropriate for publicly-traded entities will place an undue burden on private companies. Finally, we believe the type of qualitative disclosures described in the preceding comment, above, are far more useful and cost-effective for investors in non-public entities like venture capital funds than any quantitative measurement uncertainty disclosures.

⁵ Id. p. 2, footnote 2.

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2. Unit of Account (Control Premiums and Minority Discounts)

ISSUE

ED Question 6: *“The Board has decided to specify that other premiums and discounts (for example, a control premium or a noncontrolling interest discount) should be taken into account in fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy when market participants would take into account those premiums or discounts when pricing an asset or a liability consistent with the unit of account for that asset or liability.*

- a. *Do you think that proposal is appropriate? If not, why not?*
- b. *When the unit of account for a particular asset or liability is not clearly specified in another Topic, how would you apply that proposed guidance in practice? Please describe the circumstances (that is, the asset or liability and the relevant Topic) for which the unit of account is not clear.”*

We think the proposal is appropriate, but have concerns regarding applying the proposed guidance. In particular, we see a potential problem in applying the unit of account concept to VCFs.

Paragraph 820-10-35-2B of the Proposed ASU suggests that discounts or premiums depend on whether market participants would take them into account. This suggests that in certain circumstances control premiums or discounts are appropriate. However, paragraph 820-10-35-2D says that whether an asset is a standalone asset or part of a group of assets depends on its “unit of account.” The Proposed ASU says that the “unit of account” will be determined based on “the requirements of other Topics.”

Topic 946, the key accounting standard for investment companies in general and VCFs specifically, does not specify a unit of account. Therefore there is a risk that the standard will be read to say that the unit of account for a venture capital fund is a single share. This risk is heightened by the suggestion in the ED that the default unit of account, absent another controlling standard, is the individual security.⁶ In VCF financial reports, this conclusion could lead to the need to separately value each individual series of securities in a VCF portfolio.

COMMENT

In order to be consistent with the basic principles of fair value measurement, valuation of the VCF’s holdings in each venture-backed company requires judgment as to what the VCF would receive in an orderly sale to a market participant. We are concerned that the Proposed ASU could cause auditors to veer away from application of this basic idea and instead require a rigid formulaic approach. Such an approach could yield individual valuations of each series of

⁶ See, e.g., BC42, “In many cases, the unit of account for a financial instrument is the individual financial instrument.”

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securities issued by a portfolio company or each individual share in a portfolio company. Reporting values in this way would be inconsistent with the way venture capital portfolios are managed and would obfuscate key information that VCF investors and other market participants find useful.

Venture-backed companies are usually supported through the sale of securities in successive series to VCFs. A VCF that funds a company through the purchase of its first private offering of securities will often continue investing through purchase of shares in each successive series. Therefore, a VCF's investment in a single company will usually consist of an aggregation of securities in Series A, B, C, D, *etc.* Since each offering of securities is based on the need to fund expansion or continuation of a company in light of its existing financial position, the preferences granted to holders of each new series of securities often affect the rights of holders of prior series or rounds of financing.

In the case of a company that has not yet found a clear path to success, a Series D offering, for example, may need to grant liquidation preferences to its purchasers that would have the practical effect of making the value of Series A through C securities very uncertain. VCFs address this situation regularly and do not concern themselves with the valuation impact of new preferences on prior rounds unless it is clear that these preferences are likely to come into effect. This is appropriate since VCF investors (and market participants) often do not consider the value of a single series as independently material due to the complex rights and interrelationships within classes of securities and across the entire shareholder base. These rights may be documented in a variety of ways including a stock purchase agreement, an investors' rights agreement or a registration rights agreement, in addition to the agreements governing the individual securities themselves.

Therefore, investors view the value of the VCF's total investment in the company as the one relevant metric. Thus the most relevant "unit of account" for a VCF would be the bundle of rights that are represented by the sum of the rights and obligations that make up a fund's total interest in the portfolio company.

A VCF typically delivers investment returns to its limited partners on an enterprise basis through one of three distinct events: a public offering of the portfolio company's common shares (at which time all privately offered securities convert to common stock followed by a subsequent sale or distributions of common shares over time); a sale of the entire company to a third party, or; a winding down and liquidation of the portfolio company. VCFs seldom sell any portion of their investments in a portfolio company's securities prior to a public offering or sale of the company. There is rarely a market for a single series of venture-backed private portfolio company securities and absolutely no market or transactions in individual shares of a series.

In fair value measurement terms, a market participant (e.g., a long-term VCF investor) sees no independent relevance in the value of a single series of securities where multiple series have been issued. Investors sees value in the VCF's share of the total enterprise value since returns are usually realized through either a sale of the VCF's entire position in a company or the conversion of all securities to common stock in a public offering.

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Valuation of the accumulated series of securities together is clearly consistent with the Board's decision described in paragraph BC41 of the Background Information and Basis for Conclusions "to use the principle underlying a fair value measurement" and allow for such discounts and premiums as a market participant would take into account. A purchaser of VCF assets (the market participant) effectively nets all premiums and discounts associated with any single securities series into a single purchase price based on enterprise value.

Therefore, in response to Question 6b in the ED, we strongly recommend that the ASU make it clear that the "default" unit of account, absent a definition in another standard, is the unit of account most relevant to a market participant, whether another Topic addresses unit of account or not. We also recommend that references to the fact that a single security may be the unit of account in this context be eliminated unless the language is modified to say that a combination of different securities or rights may also be the appropriate unit of account.

In the alternative, we recommend that FASB specify that investment companies may use a "group" or "block" of like securities to determine the appropriate unit of account.

3. Blockage Factors

ISSUE

ED Question 5: *"The Board has decided to clarify the meaning of a blockage factor and to prohibit the use of a blockage factor when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?"*

COMMENT

We recognize that the FASB has taken the position that a discount must be based on an attribute of the security and not the holder. We urge the FASB to reconsider that position in light of the fact that it results in GAAP valuations that are not consistent with fair value principles in every market. We understand that blockage is probably not appropriate where a security has liquidity support, analyst coverage and continual transactions. However, in other markets where many VCF holdings trade, there is much less transactional volume and a dearth of market information about the security. It is only rational for a market participant purchaser to demand a discount for a large position sold into such a market.

When a VCF sells into a thinly traded market with few ready buyers, the bid price falls, potentially damaging both the public company and investors. The result is the same if the VCF distributes its block of shares to its limited partners since they typically sell immediately. An orderly sale of a large block of stock (e.g., a non-controlling interest of a size that represents a multiple of a typical day's trading volume for the company's shares) would typically require a discount to the single-share market price. In general, discounts are applied in proportion to the size of the offered position relative to its normal trading volumes.

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Furthermore, in the VCF context, “holder” restrictions like underwriter holding periods have the same impact from the perspective of the reporting entity as “market” restrictions like Rule 144A trading restrictions on the security. Applying fair value principles to a VCF, holder and market restrictions are distinctions with no real difference.

Therefore, if a VCF were to record the value of all public securities at a single share price times the number of shares, without regard to the relationship between the size of the holding and the size of the market for the securities (e.g., daily trading volume), it would not be “true” fair value. The strict arithmetic approach embodied in this requirement fails to recognize the practical judgment that a market participant would exercise regarding “blockage” and thinly traded securities.

For these reasons, we recommend that the Board reconsider its position and permit “blockage” in circumstances where a market participant would require a discount to purchase the block of securities regardless of the formal basis for the restriction.

4. Calibration

ISSUE

We have an ongoing concern about the way Topic 820 can lead, in practice, to overly rigid application of formulaic approaches to fair value.

COMMENT

As noted throughout this and other NVCA comment letters on fair value standards, valuation of VCF assets requires judgment based on all facts and circumstances. The relevant circumstances include recent transactions, but valuation must also give significant weight to qualitative considerations inherent to the practical experience of seasoned venture capital professionals.

We support the notion of calibration of valuations. As we understand calibration, the goal is to ensure that preparers adjust inputs to include those most relevant to current valuations. Therefore, we recommend that the explanatory language in the last sentence of paragraph 820-10-35-35C be amended to state that calibration does not require that all subsequent valuations rigidly reflect initial valuations but rather are adjusted to the most current and relevant inputs.

5. Investment in Debt and Equity

ISSUE

ED Question 2: “The Board has decided to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. Are there situations in which those concepts could be applied to financial assets or to liabilities? If so, please describe those situations.”

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COMMENT

The Proposed ASU changes the valuation premise language by removing the notions of “in use,” making “in exchange” the default premise. We are concerned that these changes in combination with the removal of “highest and best use” consideration for financial instruments could result in some VCF assets being booked at values below their fair value. While it is unclear that the Proposed ASU intends this, it is possible to read it as changing the way that debt and equity are valued if a VCF owns both in the same underlying company. We believe that there are clearly situations where financial assets have a “use” in combination with other financial assets that makes the fair value of each greater than they would be if valued separately.

Historically, if a VCF held control equity and debt in the same underlying entity, and enterprise value exceeded the debt, the debt securities were valued at par. This is appropriate because the debt has preference over the equity. The remainder of the enterprise value is then applied to the equity. Some accounting firms have concluded that, under the Proposed ASU, the two investments cannot be valued together.⁷ Should the debt be valued on a standalone basis and the equity on a standalone basis, this could result in the parts being less than the whole.

Under the Proposed ASU, the debt would have to be valued independently of the control equity. Effectively, an income analysis for a standalone bond would need to be performed. Depending on the estimates used, it is likely, given the illiquid nature of the debt, that many would conclude that the fair value of the debt is less than par. Therefore, the proposed change would depress fair value estimates artificially by preventing the VCF from taking into account a market place participant’s view which would likely look at control equity and debt owned by the same investor together on a group or a “portfolio basis.”

Therefore, we strongly recommend that the Proposed ASU be amended to say that the notion of “in-use” and “highest and best use” should apply to groups of securities, including debt securities, where the holder also has a controlling equity position or another means of determining the capital structure of the entity.

6. Determination of the Existence of “Control”

ISSUE

An underlying question in any situation where a control premium may or may not exist under GAAP is whether legal control or practical control is most relevant. In other words, should the

⁷ See e.g., E&Y’s Hot Topic No. 2010-33: “However, the Proposed Update is clear that the use of a portfolio approach as a practical expedient for measuring the fair value of financial instruments is not applicable when the reporting entity does not have offsetting risk positions (i.e., both assets and liabilities within the group). For example, the proposed guidance would not allow a reporting entity to measure the fair value of a group of financial assets on a portfolio basis. **Instead, the fair value would need to be determined for each individual financial asset.**” [emphasis supplied].

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question of whether a VCF entity has “control” for purposes of applying a control premium hinge on its control *per se* or on whether it has control through relationships with co-investors?

COMMENT

We believe that the principles of fair value require that control should be determined on a practical basis, i.e., does the reporting entity have the level or type of control that a market participant would pay a premium to acquire? The typical VCF, as a single reporting entity, seldom has a large enough portion of voting stock or board seats to constitute legal “control” of a portfolio company. However, they often have effective control by virtue of consistency of interests with co-investors. It is possible that such co-investors can be other funds that are managed by the same venture capital firm. They also can be VCFs managed by unrelated venture capital firms within a syndicate of investors.

In either case, it is our view that questions of “control” in valuation should be addressed from the perspective of the market participant. If a VCF has sufficient effective control to cause a market participant to assign a premium to the value of an asset, a control premium should be appropriate regardless of the relative size of the reporting entity’s holding or its unilateral ability to control the portfolio company. As with other areas of fair value, the key judgments may be qualitative. The standard should be clear that the preparer’s judgment, based on all factors, should not be over-ridden by any rigid quantitative or legal test of control.

7. Contingent Assets

ISSUE

There is diversity in practice as to the proper accounting treatment for recording contingent assets (or “contractual rights” as assets) at fair value. In our experience, the diversity exists among the auditors of VCFs, accounting experts, practitioners and the preparers of the financial statements of VCFs. We believe the diversity exists due to the inconsistent application of GAAP in situations where earn-outs or other contingencies apply to assets. Absent clarity from the FASB on the issue, this diversity could undermine the very important use of net asset value (“NAV”) by venture capital fund limited partners.

BACKGROUND

Sales of portfolio companies – as opposed to initial public offerings – are becoming an increasingly frequent form of exit or liquidity for VCFs. At the same time, it is increasingly common for the purchaser of such portfolio companies to allocate a significantly larger portion of the total consideration, usually in the form of cash or stock, as contingent consideration due to greater risks in the marketplace and purchasers’ ability to allocate that risk to the seller. The future consideration, a right based on the purchase contract, may depend on meeting certain performance milestones, financial milestones, or other contingencies.

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On one hand, some auditors and preparers insist that Topic 450 *Contingencies* (formerly FAS 5) precludes recording contingencies, so no value can be recorded. On the other hand, others rely on a non-consensus EITF decision on topic 09-4 and/or FAS 141, reasoning that if an asset can be fair valued, it can be recorded.⁸ Therefore, there are situations where different VCFs, managed by the same venture capital firm, using different auditors will report fair value for the same asset in one fund and not in another.

COMMENT

We believe that it should be permissible for preparers to record contingent assets at fair value when it can be appropriately measured pursuant to Topic 820. Topic 946 requires all investment company assets to be recorded at fair value.⁹ On this basis, the NAV reported by a venture capital fund to its limited partners is the best measure of the value of each investor's position in the VCF. An accurate NAV should include the fair value of any and all contingent assets.

Topic 450 based treatment seems conceptually out of step with the Topic 946 requirement to record all assets at fair value and the overall trend toward determining fair value based on all factors, including the likelihood that value will be realized. We believe the "Topic 450 treatment" is a vestige of an accounting mentality that predates wide-spread use of fair value.

Moreover, this approach is raising concerns among investors in VCFs who see that contingent assets have value and question why they are recorded with absolutely no value placed upon them. They may also reasonably ask how we estimate the fair value of assets based on unobservable inputs when we cannot value a right to receive a quantified return, which is likely observable and measureable, simply because it is subject to some uncertainty. Moreover, it is not unusual for a single investor to be a limited partner in more than one VCF that holds the same contingent asset or contractual right. While varying measures of fair value are to be expected, wildly inconsistent valuations raise obvious concerns.

We believe that recording fair value is the correct treatment and that it should be given a solid footing based on Topic 946 and the fair value measurement standard rather than the EITF/FAS 141 analogy.

Even though our concern may be more focused toward the Financial Instruments Exposure Draft, we feel it is important to raise this issue in this comment letter since it is highly relevant to Investment Company accounting and the ability of VCFs to report all assets at fair value. Should

⁸ The Financial Instruments ED, Paragraph BC 142 seems to support the latter position in that it says: "The Board believes that all contingent consideration arrangements would be within the scope of the proposed guidance, unless they are specifically excluded, because they would meet the definition of a *financial instrument*, which encompasses all contractual rights and obligations that are financial assets and liabilities, even those that are contingent on a specified event." However, the paragraphs following BC 142 under "Contingent consideration arrangements" deal only with contingent consideration in business combinations.

⁹ AICPA Audit & Accounting Guide Investment Companies, paragraph 1.35

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the Financial Instruments standard preclude a VCF from recording contingent consideration at fair value, the consequences would be considerable and unfortunate. Indeed, it could lead to the question, “Is there a new 'historic cost' exception to fair value accounting?”

Therefore, we believe that the FASB should make it clear in the Fair Value ASU that contingent assets can be fair valued based on all relevant inputs and should be recorded at fair value consistent with Topic 820 unless specifically prohibited in the relevant Accounting Standard Topic (e.g., Topic 946).

Paragraph 820-10-35-59 (codified from ASU 2009-12) provides a clear, practical and highly desirable rule allowing venture capital fund investors to estimate the fair value of their interests in VCFs using NAV as calculated by the venture funds. VCF investors’ use of NAV is conditioned on their conclusion that a reported NAV is based on the fair value of fund portfolio company assets. If contingent assets are not recorded and included in NAV, investors could conclude that they cannot reasonably rely on reported NAV. Were this to occur, both limited partners investors and venture capital funds would incur significant additional cost and effort to adjust NAV to ensure it is fair value. This would bring no offsetting benefit in financial reporting.

Therefore, we urge the Board to use this ASU to clarify that Topic 946 requires contingent assets (or contractual rights) to be recorded at fair value for those preparers required to use fair value accounting, including values that are based on Level 3 inputs, and that this supersedes ASC 450 for fair value preparers.

8. Elimination of “Undue Cost and Effort” Language

ISSUE

In paragraph 820-10-35-54A, the Proposed ASU eliminates some important language regarding the limits to which a preparer must go in order to obtain unobservable inputs. The previous wording that limited the search said that “unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort ...” [emphasis supplied]. The proposed language that replaces this key language in the fourth sentence of the paragraph says merely that an entity “shall not ignore information ... that is reasonably available.” Furthermore, the Proposed ASU would eliminate the entire fifth sentence of the paragraph which reads: “Therefore, the reporting entity’s own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.”¹⁰

¹⁰ Proposed ASU, page 61. [emphasis supplied].

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COMMENTS

The “undue cost and effort” language should be restored.

For VCFs, the “undue cost and effort” language is significant. When the Fair Value measurement standard was developed, we were deeply concerned that a requirement to seek out external information that a market participant might use invited auditors to require an unspecified level of search for external information. Therefore, we saw the addition of the undue cost and effort language as among the most important elements of the final standard. In practice, this language has been a buffer against auditor requests for more and more costly analysis based on highly speculative third-party inputs. Recent experience dealing with the issue of how far one must go to find elusive inputs that theoretical market participants might consider tells our members that this “buffer function” is as important now as it has ever been. We expect that VCFs, and their investors, will incur significant and unnecessary new costs should this language be deleted. Therefore, we strongly urge the FASB to continue to include the “undue cost and effort” language to the fourth sentence of the paragraph.

In addition, the deletion of the fifth sentence in the current standard can be read to eliminate the “undue cost and effort” threshold from a preparer’s obligation to evaluate whether a market participant would use different assumptions. The change would likely have an effect similar to the proposed changes to the fourth sentence. The total elimination of this language from the Topic would send a signal that the FASB intends a substantive change in practice, a change we believe will be costly.

We are encouraged by the fact that this Proposed ASU is generally not intended to change the application of the standard and that nowhere in the Proposed ASU does it indicate that the elimination of this language is intended to effect such a change.

We strongly believe that the standard without the “undue cost and effort” language will be applied in ways that will require a more costly search for information that is not decision-useful for users of VCF financial statements. Therefore, if the “undue cost and effort” language is not restored, it is imperative that the standard explicitly state that the elimination of this important language is not intended to heighten in any way the burden on reporting entities to pursue reasonably available information on the question of whether a market participant would use different assumptions or how far a preparer must go in pursuit of information relevant to those assumptions. Otherwise, we are all but certain that this revision will cause a substantive change in the practical application of the standard.

ED Question 11: “Should any of the proposed amendments be different for non-public entities?”

We believe there is an important distinction to be made here between the needs of the users of private company financial statements and the users of public company financial statements. As we note in our comments on measurement uncertainty, investors in VCFs and other private entities have access, if required, to information far beyond that contained in the financial statements. Preparers are responsive to them. The buffer of undue cost and effort is important

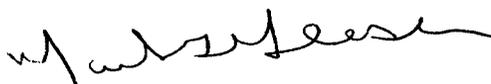
*National Venture Capital Association
Comments on Proposed ASU, Fair Value Measurement and Disclosure (Topic 820),
File Reference No. 1830-100.
September 7, 2010*

because it helps diminish the waste of fund assets and resources attempting to obtain information for which there is no investor demand. Therefore, while there may be reasons for increasing the search for third party information in the public company or in the international context, we urge that the undue cost and effort message be retained at least for private VCFs.

CONCLUSION

NVCA appreciates the opportunity to provide these comments. If we can be of further assistance please do not hesitate to contact us.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Mark G. Heesen', written in a cursive style.

Mark G. Heesen
President