



June 21, 2013

VIA Email

Technical Director
File Reference No. 2013-250
FASB, 401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Director@FASB.org

RE: Exposure Draft, *Private Company Decision-Making Framework -- A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*

INTRODUCTION

The National Venture Capital Association (“NVCA”) represents the vast majority of American venture capital under management.¹ Venture capital funds provide start-up and development funding for innovative entrepreneurial businesses. We appreciate the opportunity to comment on the Exposure Draft of the *Private Company Decision-Making Framework*.

Venture capital funds (“VCFs”) are both users and preparers of private company GAAP financial statements. Funds report to their limited partner investors (“LPs”) as investment

¹ Venture capitalists are committed to funding America’s most innovative entrepreneurs, working closely with them to transform breakthrough ideas into emerging growth companies that drive U.S. job creation and economic growth. According to a 2011 IHS Global Insight study, venture-backed companies accounted for nearly 12 million jobs and \$3.1 trillion in revenues in the United States in 2010. As the voice of the U.S. venture capital community, the National Venture Capital Association (NVCA) empowers its members and the entrepreneurs they fund by advocating for policies that encourage innovation and reward long-term investment. As the venture community’s preeminent trade association, NVCA serves as the definitive resource for venture capital data and unites its 400 plus members through a full range of professional services. For more information about the NVCA, please visit www.nvca.org.

companies. Nearly all are private entities. NVCA members are venture capitalists who act as general partners (“GPs”) of venture capital funds. They invest in private companies in many industries and in stages of development that range from early stage startup to pre-IPO companies. Also, some NVCA members manage funds of funds which invest in venture capital funds and, as such are users of venture capital fund financial statements. Therefore, our comments are based on three perspectives: (1) VCF (or GP) users of general purpose financial statements from portfolio companies; (2) preparers of VCF financial statements prepared under Topic 946, and; (3) LP users of VCF statements prepared under Topic 946.

NVCA has supported the many efforts to adapt GAAP to private companies including the Private Company Financial Reporting Committee, the Blue Ribbon Panel and the development and creation of Private Company Council. NVCA and its members’ representatives have participated in numerous panels, committees, working groups and roundtables regarding the application of FASB rules and its rulemaking process to private entities.² We remain intensely interested in the adaptation of GAAP to fit the needs of private company investors and financial statement users and would be pleased provide the Board and the PCC with any assistance we can make available.

We appreciate the consideration given to our critical comments regarding parts of the Discussion Paper on the Framework. We note the progress made in the Exposure Draft Framework (“ED Framework”) toward appropriately neutral treatment of entities like investment companies that report under specialized accounting guidance. We have additional comments on this topic under Question 4 below.

GENERAL COMMENTS

Question 3: *Overall, do you agree that this guide would lead to decisions that provide relevant information to users of private company financial statements in a more cost-effective manner? If it does not, what improvements can be made to achieve those objectives?*

As a general matter, the ED Framework is an important step toward guiding the Board and the PCC toward decisions that will facilitate more cost-effective financial reporting. However, in order to accomplish that objective the final Framework needs to place more emphasis on:

² Leaders from NVCA member firms participated or continue to participate in the FAF/AICPA/NASBA Blue-Ribbon Panel on Standard Setting for Private Companies, the Private Company Financial Reporting Committee and the FASB Small Business Advisory Committee. NVCA also filed extensive comments on the FAF’s *Plan to Establish the Private Company Standards Improvement Council* based on guidance from our CFO Task Force.

Comments of the National Venture Capital Association
Exposure Draft, *Private Company Decision-Making Framework*
June 21, 2013

- cost,
- complexity,
- access to management, and
- financial statement “lag”

Our responses below, offer specific comments on these points.

QUESTION 4 -- PRIVATE INVESTMENT COMPANIES AND INDUSTRY SPECIFIC STANDARDS

Question 4a: Do you agree that this guide appropriately considers industry-specific accounting guidance for private companies? That is, should private companies follow the same industry-specific guidance that public companies are required to follow in instances in which the Board and the PCC determine that the guidance is relevant to financial statement users of both public companies and private companies operating in those industries? If not, why?

As noted, venture capital funds are private investment companies that follow the industry-specific guidance in Topic 946. The ED Framework is a significant improvement over the Discussion Paper version of the Framework in that it eliminates the “presumption” language regarding companies that report under industry-specific guidance. However, more improvement is needed.

Paragraphs 1.11 through 1.13 on “Industry-Specific Guidance” are unnecessary and potentially prejudicial to the interests of users and preparers of financial statements that are based on industry-specific guidance. Part of paragraph 1.11 states an appropriate basis for the Board and the PCC to consider whether private company alternatives should apply to companies that report under industry-specific guidance. It says that recognition and measurement guidance for entities that use specialized accounting “could be equally relevant” and there is a “potential need for greater comparability” in these situations. [emphasis supplied]. Of course, the FASB has long used just such considerations in determining whether to make exceptions or practical expedients for private investment companies in the past.

As stated in our comment letter on the Discussion Paper, the “Significant Differential Factors” that underlay the whole purpose of the PCC apply in the venture capital industry.³ We are therefore concerned that, while Paragraph 1.11 avoids the highly-prejudicial “presumption” language of the Discussion Paper, it still places private companies that report under “industry-specific” guidance in a disadvantageous position.

³ Private venture capital funds and public investment companies differ in each of the six ways set out in Paragraphs 13 and DF1 of the ED Framework.

We are especially concerned about the phrase “[r]egardless of other factors that differentiate private companies from public companies” that begins the third sentence of Paragraph 1.11. It could easily be read as a subtle means of retaining the inappropriate presumption that private companies that use industry-specific guidance should be subject to special scrutiny or presumptions despite the fact that the Significant Differential Factors or an analysis of benefits and costs under Paragraph 1.4 clearly indicate that an alternative is appropriate.

Therefore, we urge that the section of the Framework titled “Industry-Specific Guidance” (Paragraphs 1.11 – 1.13) be dropped from the final Framework. At a minimum, the phrase “[r]egardless of other factors that differentiate private companies from public companies” in Paragraph 1.11 should be excised from the final document.

Question 4c. *Do you think that industry-specific accounting considerations should be different between (i) recognition and measurement and (ii) disclosure?*

Paragraphs 2.2, 2.7 and 2.10 of the ED Framework contain an inappropriate presumption against private companies that report under industry-specific guidance. Paragraphs 2.2 and 2.7 say that once the PCC has determined that “industry-specific” disclosure guidance is “relevant” to both private and public companies it “generally should require private companies to provide the same disclosure as public companies.” The Chart at Paragraph 2.10 indicates the same. We firmly disagree, especially given the risk that “relevant” is defined or considered in a way that ignores cost, complexity and timeliness. Such a presumption also runs contrary to past practices of the FASB in granting relief to private companies from unnecessary and costly disclosure requirements.

Cost effective financial reporting should almost mandate that private company disclosure is different than that for public companies. This is true for all financial reports, not just those prepared under industry-specific guidance. The key information for venture capital fund investors is contained in the basic balance sheet, the income statement and other performance metrics specific to a given business model.⁴ Comparability is far more important in this type of recognition and measurement information than in disclosure. Comparability of disclosure and disclosure in general is far less important to VCFs as investors and to LP investors in VCFs. Furthermore, the basic financial statements, and notes thereto, do not provide all of the relevant

⁴ Of course, in all successful investments there comes a time when GAAP financial statements will be needed for a potential buyer or an IPO filing and as a company matures. Details consideration regarding revenue recognition and other GAAP metrics become important factors in a company’s planning and preparation. But in the early stages of a company’s development, GAAP financial reporting is secondary to management accounting and cash flow management.

information LPs receive.⁵ Fundamentally, for investment companies, GAAP requires a number of disclosures which are not meaningful, and does not require information which to selected investors is meaningful. (Note further discussion below).

Relevance has a different meaning to users of private company statements. VCF users generally look to simpler financial metrics than the complex disclosure directed toward financial analysts in public companies. Additional time necessary to prepare and audit more complex disclosures that users don't need or can't understand deprives these investors of more decision useful information in GAAP financial statements.

There is a critical need to address the cost, complexity and confusion that exists as a result of disclosure requirements. As users of private operating company statements and investment company statements, as well as preparers of statements for VC fund LPs, we know that investors ultimately pay for financial reports they receive. While public companies may face similar difficulties, the problems are magnified for private companies by all the reasons underlying the Six Significant Factors that distinguish private companies from public companies.

In particular, there are fundamental differences in the cost-benefit impact of information in financial statements of public and private investment companies, especially in disclosure. Venture funds and venture fund LPs are investors, not analysts. They want to pay only for information that is of practical use in understanding their investments and in making investment decisions. Information that is of theoretical value or information that might be useful at some later date fails their cost-benefit calculation. Therefore, the final Framework should be clear that considerations such as cost, complexity, access to management and lag in financial reporting are especially important in determining the usefulness of disclosure requirements for private companies.

Question 4b. *Do you think factors other than user relevance, such as cost and complexity, should be considered when the Board and the PCC are determining whether or not to provide alternatives within industry-specific guidance?*

Yes, and the Framework needs to be substantially revised to reflect it. For venture funds and for their LP investors the cost of preparing financial statements and the usefulness of the information are not separable from the question of relevance. They are each part of the same cost-benefit choice, i.e., "is it useful information and can it be obtained at a reasonable cost?"

⁵ For example, in September 2012 the International Private Equity and Venture Capital Valuations Board (IPEV) developed *Investor Reporting Guidelines*, identify a number of relevant information items which are desired by investors but which are not required by GAAP.

Venture capital fund managers and their LP investors are users who have access to management and bear the cost of financial reporting as owners of the reporting entity. Therefore, we are concerned that the ED Framework can be read to separate “relevance” and elevate it over “cost.” Paragraph 2.6 says: “[i]n evaluating potential disclosure alternatives for private companies within U.S. GAAP, the Board and the PCC also should consider, but place less weight on, the cost of providing the disclosures, both in terms of the cost incurred by the preparer and the efforts spent by the user to sort through disclosures that may have limited or no relevance (factor (e) in paragraph 2.3).” [emphasis supplied.] This statement appears to regard relevance as an attribute of information that can be meaningful in the abstract. While this may be true (in the abstract), we think the Framework should emphasize a more straightforward balance of the benefits to the user of having the information in GAAP financials versus the cost of obtaining it under GAAP, or by another means. We recommend that the final Framework be revised to emphasize “usefulness” of information and a more straightforward cost-benefit balance as opposed to the ED Framework’s bias in favor of “relevance.”

QUESTIONS FOR DETERMINING “RELEVANCE TO USER”

Questions 6: *Paragraph 1.5 includes the following questions for the Board and the PCC to consider in the recognition and measurement area of the guide:*

1.5(e) Does the guidance require that the threshold for recognizing or measuring a transaction or event be at least probable of occurring?

1.5(h) Is it likely that users that are interested in the transaction, event, or balance can obtain information directly from management that can reasonably satisfy the objective of the guidance?

1.5(i) Is the lag between the year-end reporting date and the date financial statements are issued and made available to users likely to significantly dilute the relevance of the information resulting from the guidance?

Do you believe that the questions listed above are necessary for considering alternatives for private companies within recognition and measurement guidance? Or are the other questions in paragraph 1.5 sufficient for considering when alternative recognition and measurement guidance is appropriate for private companies within U.S. GAAP?

Each of the subparagraphs of Paragraph 1.5 highlighted by Question 6 is important to the consideration of relevance. Our comments are set out separately below.

Recognition Thresholds and Probability

Subparagraph 1.5(e) is important because it recognizes that any event with a probability level lower than “probable” may not be relevant in private company financial reporting.⁶ This question also presents the need to distinguish between industry specific guidance and public versus private guidance. Even to the extent that current GAAP already has different regimes for reporting similar transactions, the question highlights the need to maintain the possibility of having separate industry specific guidance on both sides of the public/private divide.⁷

Management Access

Subparagraph 1.5(h) regarding management access is particularly important. We disagree with the treatment of management access under “Further Considerations” in paragraph 1.9, which says, “[m]anagement access should not be a dominant factor in deciding whether to permit an alternative for private companies within U.S. GAAP.” Access to management is the fundamental difference between private and public companies and a major driver of the long debate that led to the creation of the PCC.⁸ Regulatory barriers between management and investors in public companies are a key driver of this distinction.

SEC Regulation FD greatly restricts management in sharing financial information that is not publicly filed with the SEC. No such legal barrier exists for private companies. The fact that investors in private companies are free to seek additional information from management is a fundamental difference in the financial reporting mechanism for such investors. VCF GPs are users of portfolio company GAAP financial statements and they are also users of financial information that they obtain from management in a manner that is far more timely and relevant than audited financial statements.⁹

⁶ Implementation of FIN 48 on Income Taxes, for example, has caused a great deal of wasted time and effort to address taxable events that are either remote or immaterial. Relief for private companies regarding such events would be appropriate.

⁷ For example, a midsized private financial company may regularly engage in derivatives type transactions, whereas a small importer may enter into an occasional hedging transaction for a purchase of next month’s inventory order from overseas. These two scenarios vary not only between the sophistication of the preparer companies, but also in the likely users of the financial reports. Even a lender to the financial services company may be expected to want to understand the various complexities of the company’s derivatives portfolio, but a lender or trade creditor to the import company may not have the sophistication to evaluate all of the applicable GAAP requirements for reporting the isolated transactions.

⁸ See Blue-Ribbon Panel on Standard Setting for Private Companies, *Report to the Board of Trustees of the Financial Accounting Foundation* (January 2011).

⁹ Substantially all venture capital investments in private companies involve some contractual rights that provide direct access to management reports, in addition to more formal financial reports under GAAP. Most VCFs are required to have “management rights” in order to retain venture capital operating company (“VCOC”) status, a critical part of certain LP’s compliance with the ERISA law.

Therefore, management access -- or the absence of legal barriers to communications with management -- is not only an important element in Paragraph 1.5, it is among the most important aspects of private company reporting. The Framework should be revised to reflect this fact.

Lag in Receipt of Audited GAAP Financials

Subparagraph 1.5(i) raises an important question; however, the use of the adjective “significantly” in the phrase “likely to significantly dilute the relevance of the information resulting from the guidance” seems to set an unnecessarily high bar for consideration. The normal lags between the end of a period and the GAAP financials dilute their usefulness. The length of the lag affects the “relevance to the user” and the only meaning that can be ascribed to the adjective “significantly” is to make it easier to gloss over the impact of these lags.

To be more concrete, the lag between the year-end and the issuance of audited financials affects the relevance of information in audited GAAP financial statements. VCFs usually receive an unaudited balance sheet, income statement and non-GAAP performance metrics directly from management in the first or second month after the end of a fiscal year. This information is highly relevant and decision-useful for investors. The time lag between this information and receipt of audited financial statements is often a matter of quarters, not months.¹⁰

Since it is fair to ask why VCFs do not insist on more timely audited financial statement, we have asked our members. It seems that the requirement to produce overly complex and irrelevant information in audited financial statements is at the root of the lag for two reasons. The first is simply that audit requirements and disclosure tables cause significant delay in producing audited financial statements. Second, VCFs do not object to their investee companies delaying their audits until times when audit fees are lower because so much of the information in current GAAP financials is generally not decision-useful (relevant) no matter how timely it is delivered. Indeed, a typical VCF must issue fair value based financial statements to its LP investors within 30-45 days after the close of a quarter -- long before portfolio company GAAP financials could be available.

Since VCFs know that as investors they ultimately pay for financial reporting it is not in their interest to encourage portfolio companies to pay for audits during auditors’ “busy season.” Finally, VCFs generally obtain and report information about the performance and fair value of

¹⁰ Audited GAAP financial statements are usually not available until the fifth or sixth month following the fiscal year end and sometimes are not available until the ninth or tenth month. Therefore the audited financial statements are useful to VCFs primarily as a means of comparing some metrics in the financial statements to prior year audited financials, ie., their usefulness/relevance is limited. See also, *Infra*, note 4.

underlying investee companies on a quarterly basis. The rigor required to monitor and report quarterly information is virtually the same as that required for annual information. Therefore, audited financial statements become more of a check the box exercise than one that provides decision useful information. Therefore, lag is a result of complex reporting requirements (and arduous audit procedures), which diminished the usefulness of the information. In addition, the existence and length of this lag also demonstrates the limited relevance of much of the information that is currently required in private company GAAP audited financial statements.

MANAGEMENT ACCESS AND RED FLAG APPROACH TO DISCLOSURE

Question 5: *Do the different sections of this guide appropriately describe and consider the primary information needs of users of private company financial statements and the ability of those users to access management, and does the disclosure section appropriately describe the red-flag approach often used by users when reviewing private company financial statements (see paragraphs BC45 and BC46)? If not, why?*

As noted under Question 6 above, we do not think the ED Framework places sufficient emphasis on the significance of management access as a basis for different accounting requirements for private companies, especially disclosure requirements.

With regard to the “red flag” approach, Paragraph BC46 appear to set out an appropriate description of disclosure that complies with that approach, ie., “basic information necessary to facilitate a user’s review and to allow a user to identify appropriate follow-up questions to present to management when the user deems it necessary to do so.”

ALL OR NOTHING APPROACH TO USE OF PRIVATE COMPANY GUIDANCE

Question 7: *Do you agree that a private company generally should be eligible to select the alternatives within recognition or measurement guidance that it deems appropriate to apply without being required to apply all alternatives available to private companies within recognition and measurement? Do you agree that, in certain circumstances, the Board and the PCC may link eligibility for application of alternatives within recognition or measurement in one area to the application in another area? If not, why?*

Our members’ views are mixed on this question. NVCA strongly supports the PCC’s mission in identifying appropriate distinctions for private company reporting. As users of private company financial statement, VCFs naturally value comparability of information, especially on recognition and measurement. However, while some members favor consistency within an

Comments of the National Venture Capital Association
Exposure Draft, *Private Company Decision-Making Framework*
June 21, 2013

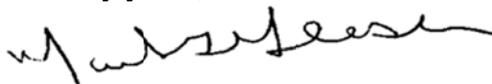
entity as to whether it is using “private company GAAP” or “public company GAAP,” other members believe it is imperative for reporting entities to be able to evaluate the costs and benefits of applying private company accounting alternatives on an individual basis.¹¹

Therefore, we recognize that there may be sound policy reasons for the Board and the PCC to either allow or disallow standard-by-standard election. We also see the potential need for the Board to mandate linkage between certain alternative treatment and other related elements of the financials if all-or-nothing is not the general rule.

CONCLUSION

We appreciate the Board and the PCC considering our comments on the ED Framework. NVCA would be pleased to work with the FASB on these important matters. Please feel free to contact me or Jennifer Connell Dowling, Senior Vice President, at 703 524 2549.

Sincerely yours,



Mark G. Heesen
President

¹¹ Successful venture capital portfolio companies that adopted private company reporting would almost certainly transition to general GAAP as they approach a liquidity event (and to the extent that they wish to communicate further information outside the financial report, they could elect to do so). Flexibility in this transition would be better than a requirement to switch from using private company alternative to not using any of them in a single quarter.