



July 11, 2014

VIA Email

Technical Director
File Reference No. 2014-200
FASB, 401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Director@FASB.org

RE: *Proposed Statement of Financial Accounting Concept, Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements.*

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.

Venture capital funds (“VCFs”) invest across the spectrum of company stages of development, typically from early stage startup through IPO or acquisition. As such they bring a users’ perspective to financial statement notes. Venture funds also report to their limited partner investors and prepare financials under Topic 946 as investment companies. A few NVCA members manage funds of funds that invest in venture capital funds and are therefore users of these VCF financials.

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. 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 nearly 400 members through a full range of professional services. For more information about the NVCA, please visit www.nvca.org.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

Approximately 100 of our member firms' Chief Financial Officers and Administrative Partners make up NVCA's CFO Task Force. These are the women and men responsible for financial reporting for the vast bulk of the venture industry worldwide. The CFO Task Force provides NVCA with invaluable insights into the practical impact of GAAP accounting standards on financial reporting in the venture industry.

GENERAL COMMENTS

As users and preparers of financial statements, VCFs support the goals of the FASB disclosure project and the important role that notes to financial statement can play in providing useful information to investors, lenders and other "resource providers." They strive for a level of transparency in financial reporting that is consistent with the goals of their limited partner investors ("LPs") and the basic VCF investing strategy: generating returns through the long-term success of the portfolio companies that make up fund assets.

Our long-term experience with standards on disclosure is hands-on and our comments will reflect our sensitivity to their practical impact more than our understanding of the fine distinctions made in the Exposure Draft on the Chapter 8 framework ("the ED" or "the framework"). Therefore, in addressing questions about the Board's process, we may stray beyond the confines of this particular framework document. We nonetheless believe the Board and the framework will benefit from our perspective.

We have frequently used the term "decision-useful" in commenting on FASB standards and we believe it captures an important characteristic of effective disclosure.² As the ED says, notes to the financial statements must "supplement or further explain the information on the face of financial statements by providing financial information relevant to existing and potential investors, lenders, and other creditors...." As users of financial statements and as fiduciaries to their LP investors, our members fully support and are eager to fund the cost of delivering decision-useful financial reports.

The ED notes that such disclosure is also a product of robust evaluation of benefits and cost.³ We believe that the first question the framework should ask is what purpose an investor, lender or other user would have for information in the notes. This question should include an assessment of whether the desired information can be effectively communicated through the proposed disclosure and whether the disclosure would meaningfully enhance the user's

² NVCA Comment letter on Discussion Paper: *Disclosure Framework*, November 30, 2013. ("We have found the question of whether information is "decision-useful" as a meaningful basis for evaluating disclosure requirements since it incorporates a distinction between whether information would help an investors make an investment decision as opposed to merely being of marginal interest to a particular type of investor, investment analyst or another type of user.")

³ ED, Paragraph P14, p. 3. ("The Board would have to assess the potential benefits of entities providing specific information and justify the costs of providing and using that information.")

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

understanding.⁴ We believe that these types of questions help determine whether arguably relevant information can be reported in a decision-useful way. In other words, as users and preparers we think a critical focus on the practical benefit of information in the notes would result in more effective disclosure.

Once a purpose is determined and the deliverable benefit is understood, the Board should consider the cost of using and preparing this information.⁵ Our responses to the Questions in the Exposure Draft reflect our general sense that the framework would result in more effective disclosure if it were modified in ways that better integrate a variety of considerations into the framework.

ED Questions 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?

The ED is a significant improvement over the 2012 FASB *Disclosure Framework* Discussion Paper. The ED provides more clarity as to the impact that it would have on disclosure rules that the Board would develop using Chapter 8 as a decision framework. We see no need to add or remove any particular concepts. However, we would recommend a different balance in the way the framework addresses the various concepts. We are concerned that the ED is so comprehensive as to the types of information that might be useful to any user of financial statements that it raises concerns as to how effectively the Board will be able to find the correct balance between information that might be relevant and disclosures in the notes that would be effective.

ED 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 the purpose of the notes?

Many meaningful concepts are highlighted in the articulation of the broad scope of potentially useful information and in the section on limitations on information. Each of the following factors is critical to ensuring that information is disclosed effectively.

- Relevance and materiality

⁴ There are examples in current disclosures where information is required to be aggregated or disaggregated to such an extent that an attempt to provide a summary table or narrative description may leave the reader with more data points or variables to consider, but nothing that provides greater utility to the user when making decisions about the reporting entity's overall financial position.

⁵ "[T]he Board must be sensitive to the possibilities that excessive disclosure may cause users to overlook important information and that it may be burdensome to reporting entities." ED, Paragraph D16, p. 13.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

- Recognition that some users' enormous appetites for information should not drive disclosure decisions
- Cost benefit
- Importance of other sources of information
- The limited value of assumptions or expectation about the future
- The importance of respecting potentially sensitive information

Relevance and Materiality

The Framework can be read to elevate the notion of “relevance” to a highly conceptual level. We see this as creating the risk of a bias in favor of more information without the rigorous scrutiny of actual benefit necessary for effective disclosure. We concede that relevance may be a high-level question regarding certain information; however, the framework should avoid suggesting that once relevance is established as to particular information, its value *per se* is thereafter assumed.

We are very familiar with two examples of what may be the consequence of assuming relevance and usefulness in current disclosure requirements. These are fair value disclosures outlined in Topic 820-10-55 and updated in ASU 2011-04. Our members are confident that the investors who receive and ultimately absorb substantially all of the cost of these disclosures in VCF financial statements do not use the disclosures described below.

The disclosure of “Significant Quantitative Input Assumptions Used for Level 3 Fair Value” is not only wasteful and unhelpful but it raises a significant risk of giving investors a false sense of precision. This type of disclosure had become mandatory because ASU 2011-04 presents a tabular form of this disclosure⁶ that auditors have decided is necessary. Such presentation is both costly and unhelpful to investors.

Similarly, the Reconciliation /Roll Forward of Level 3 Fair Values in a disaggregated form by security type results in wasteful and ineffective disclosure. The Level 3 roll-forward/reconciliation requirements may be useful in theory. However, because of the example of a tabular format of data⁷ in ASU 2011-04 the resulting tabular disclosure is meaningless information which cannot be reconciled to any other entry in the financial statements. This information may be relevant in some funds and the FASB may intend for appropriate judgment to be applied. However, in practice for VCFs this tabular disclosure is mandatory. Attachment 1 is an example of this type of disclosure.

⁶ ASU 2011-04, page 126 under paragraph 820-10-55-103. This table requires inclusion of the valuation technique used for each investment classified as level 3 as well as the unobservable input and range of inputs used as part of that valuation.

⁷ *Id.*, page 124 under paragraph 820-10-55-101. Auditors have made this example the norm for the level 3 rollforward disclosure and have required inclusion of the necessary disclosure of transfers in and out of level 3 as well as purchases, sales and unrealized/realized gain by level 3 security.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

VCF investors assess investment performance based upon the companies in which the fund invests. They are generally unconcerned with what types of securities the VCF employs to achieve its objectives. The aggregation by security type for the roughly 50 portfolio companies a typical VCF may have is not helpful to the user.⁸ Furthermore, it is extremely time-consuming to aggregate this information across portfolio companies and it takes even more time (and money) for auditors to audit this information.

Recognizing this, it would have been helpful for the disclosure guidance in ASU 2011-04 to have been less prescriptive in practice. Although the ASU offered the illustration as an example of what the Fund “might” include, in practice this has become a de facto requirement.

These two fair value disclosure requirements are examples of disclosures that may have theoretical relevance or be relevant in fact in some types of funds. But it is not effective disclosure. As a result, we fear that if the hierarchy by which the Board evaluates disclosures does not include greater emphasis on decision-usefulness, together with relevance and costs, the framework could perpetuate these types of requirements. We also would like to see more consideration of materiality in the Chapter 8 framework.

We recognize that it may be a venture into accounting theory to comment on the relationship between relevance and materiality. However, we believe the two concepts are more closely related than is suggested in the draft framework. The ED suggests that materiality can only be determined at the entity level as a wholly separate concept from relevance.⁹ We believe that in practice, the degree of relevance is a variable in entity-specific determinations of materiality. Therefore we question the idea that materiality should not be part of the Board’s process set out in Chapter 8.

For example, consider this concept in relation to forward-looking information or current assumptions about forward-looking information which can impact measurement in the financial statements. Almost all such disclosures acknowledge that changes in assumptions could have a material impact. Thus, would all possible assumptions associated with the proposed disclosure not be material? As a result, if relevance is determined in the absence of materiality and thus in the absence of context, the level of required disclosure could be unlimited and unworkable. Therefore, we recommend that the ED address “relevance” as an element of any information that varies with:

- the nature of the information,
- the reporting entity and
- the entity’s financial statement users.

⁸ Such information could only be meaningful if it were aggregated at the portfolio company level (all securities, by issuer), not at the fund-level by security type.

⁹ ED, Paragraph D18, p.13.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

Limitations

We appreciate that the ED objectively addresses “Limitations on Information in Notes to Financial Statements.”¹⁰ We know that in general the current Board and many prior Boards have made diligent efforts to be mindful of these limitations. However, this framework is intended to serve as a guide for future Boards, and as noted we are concerned that the ED taken as a whole would very likely create a bias in favor of the inclusion of more information in the notes.

Perhaps by design, the overwhelming weight of the ED focuses on the consideration of all possibilities for information that might be included in the notes. Appropriately but only occasionally does the ED refer to cost/benefit analysis, information overload or the availability of other sources of information. Therefore, we recommend that the section on “Limitations” should be more prominent in the introduction to Chapter 8 and more thoroughly integrated into it.

While we recognize that the framework is not intended to be an operational manual, it would also be helpful to refer to practices such as field testing and post implementation testing as part of the overall Board process. It would also help to introduce the question of whether proposed new disclosures might replace existing, less effective disclosures. Otherwise, the sheer weight of an accumulation of required disclosures will surely dilute the usefulness of that which is most meaningful.

For similar reasons we question whether the framework should be limited as stated in Paragraph P14: “This chapter of the framework would not specify how the Board should accomplish that narrowing of disclosures.” Absent a clearer recognition of the interplay of every variable that is part of determining whether certain disclosure will be effective or not, the framework will lack balance. Again, it may create a bias toward more information, but less effective disclosure.

One way to address this problem could be to list factors in addition to cost that the Board should consider as ways to narrow the scope and extent of required disclosures. Some of these factors are in the current ED. However, more emphasis is needed. Examples of these types of considerations are:

- Disclosures common to only specific industries or types of transactions may not be required in others.
- Disclosures may be redundant or inferior to other information already provided outside the financial statements.
- Disclosures may be impractical to quantify or the inputs may be un-auditable.

¹⁰ *Id.*, p.13.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

The framework should place greater emphasis on the variability of outcomes of cost-benefit analysis depending on the nature of the reporting entity.¹¹ With these differences in mind, the framework should be clear that “costs” include internal costs for the reporting entity such as systems changes, education and other implementation costs. Auditing costs should be considered as well. In addition, such costs should be measured relative to the perceived benefit to be obtained from the disclosure and in relation to the cost structure of the reporting entity and likely users.

Lastly, while we appreciate the inclusion of examples in the ED, (and note that NVCA’s comment letter on the 2012 Disclosure Framework asked for such examples), our members remind us of the impact that examples in actual standards can have on the practical requirements of financial reporting. Unfortunately, given the clear biases in audit practices to err on the side of requiring and auditing more information in the notes, we see many “examples” in standards become reporting requirements in practice.¹² Therefore, while we recognize that issues of preparer discretion may fit most appropriately into the Entity Process disclosure project, we recommend that the Board’s framework on disclosure standards caution against providing example unless they are accompanied by the clearest language stressing the importance of preparer discretion in the actual information in and format of the notes.

SPECIFIC RECOMMENDATIONS FOR IMPROVEMENT

ED 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?

With the possible exception of Question L1, Appendix A reflects the ED’s bias in favor of more information. We recommend that the section on “Limitations” be integrated into Appendix A. The exercise of well-informed discretion will result in more effective disclosure. This document should set an example by providing flexibility for the Board to exercise its judgment. It should encourage Board members to write disclosure requirements that encourage preparers and their auditors to exercise their judgment as to the level and extent of disclosure that might be most appropriate and decision-useful in specific circumstances.

¹¹ “[T]he Board seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities. That does not mean that assessments of costs and benefits always justify the same reporting requirements for all entities. Differences may be appropriate because of different sizes of entities, different ways of raising capital (publicly or privately), different users’ needs, or other factors.” ED paragraph P14, quoting Paragraph QC39 in Chapter 3 of Concepts Statement 8. [emphasis supplied].

¹² See text accompanying footnotes 5 & 6 for examples.

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

Appendix A's orientation of questions toward specific line items of the financial statements makes the questions seem like a laundry list of possible disclosures. We understand that the focus on line items helps to organize the questions into distinct concepts, but the sort of presumption that this leads to is not helpful. In addition, we are concerned that the disclosures resulting from this approach are more likely to be prescriptive than principles-based or focused on effectiveness. There is risk that the Board will feel the need to justify excluding one of these potential disclosure items more acutely than the need to justify its cost.

We recognize that "yes" answers to the questions in Appendix A "would be subject to all of the constraints listed in paragraphs D16–D31." However the constraints listed in those paragraphs are fundamental to the goal of effective disclosure and therefore should be integrated into the Appendix A "early decisions" about each item of disclosure. Given the ever-present demand for more information as noted in the ED¹³ the Board should imbed the important restraints in the beginning of the decision process.

We believe this is necessary based on our own business experience and our experience with regulatory processes.¹⁴ A more direct reference to the considerations that can weigh against the early designation as "relevant," will make the framework more balanced and more likely to achieve the overall objectives set out in Paragraphs S2 and S3. Therefore, we recommend that the following specific consideration be incorporated into Appendix A:

- The Concept Statement 3 recognition that one size does not fit all.¹⁵
- Given the significant impact of auditing the notes in financial statements on the fundamental cost benefit balance of a particular disclosure, Appendix A should contain a question about auditability.¹⁶
- Information redundancy between SEC and GAAP requirements should be eliminated unless there is a compelling reason for it. The language of the ED equivocates on this point and would make it too easy to countenance wasteful redundancy.

CONCLUSION

NVCA understands and appreciates the goals of providing a framework for the evaluation of information that might be disclosed in the notes to financial statements. We commend the Board for significant past efforts to meet the needs of resources providers for effective communication in the context of financial statements. We appreciate the Board's recognition

¹³ ED, Paragraph D16, p. 13.

¹⁴ Experience shows the way ideas gain momentum and champions. Too often benefits are assumed or demand is created by users who do not bear the cost of preparation. Therefore, if questions of cost are the second step of the process after the benefit has been "established," (or relevance is determined outside the context of materiality) those introducing are too often required to prove the cost. In other words, those offering evidence of cost (or other countervailing considerations) face a much higher burden of proof than the proponents of the disclosure of "relevant" information.

¹⁵ Note 7, *supra*.

¹⁶ ED footnote 8 at page 15 makes an excellent point that "[t]he cost and difficulty of auditing that information might, at least in some cases, change the judgment about whether costs are justified by benefits."

Comments of the National Venture Capital Association
Conceptual Framework, Chapter 8: Notes to Financial Statements.
File Reference No. 2014-200.
July 11, 2014

that this goal is an elusive one and their willingness to revisit areas where there are opportunities to improve. However, the fact that future FASBs may not share this sensitivity underscores the need for a framework that is balanced and unbiased in considering all the factors that go into effective disclosure. We appreciate this opportunity to comment and stand ready to work with the Board on this and other important matters. Please feel free to contact me at 703 524 2549 or John Taylor, NVCA Head of Research at jstaylor@nvca.org or his direct phone, 646-571-8185.

Sincerely yours,



Bobby Franklin
President & CEO

1 Attachment
“Fund IV, L.P., Notes to Financial Statements”

Attachment 1

FUND IV, L.P.
NOTES TO FINANCIAL STATEMENTS
December 31, 2013

3. Fair Value of Portfolio Investments, continued

Following is a reconciliation of investments in which significant unobservable inputs (level 3) were used in determining value:

	<u>Preferred stock/Units</u>	<u>Common stock/ Ordinary shares/ Warrants</u>	<u>Convertible notes</u>	<u>Total Portfolio Investments</u>	<u>Milestones and Contingent Receivables</u>
Balance as of December 31, 2012	\$ 352,695,688	\$ 36,860,195	\$ 5,280,095	\$ 394,835,978	\$ 22,410,067
Realized gain/loss and change in unrealized appreciation/ depreciation	183,997,616	(8,059,573)	6,369,020	182,307,063	2,371,134
Purchases	26,510,941	11,734	3,928,707	30,451,382	-
Sales	(61,993,734)	(1,105,318)	-	(63,099,052)	(11,725,394)
Conversions	(220,662,228)	222,469,791	(1,807,563)	-	-
Transfers into Level 3	-	-	-	-	-
Transfers out of Level 3	-	(221,090,629)	-	(221,090,629)	-
Balance as of December 31, 2013	<u>\$ 280,548,283</u>	<u>\$ 29,086,200</u>	<u>\$ 13,770,259</u>	<u>\$ 323,404,742</u>	<u>\$ 13,055,807</u>
Net change in unrealized appreciation/ depreciation from investments still held as of December 31, 2013	<u>\$ 23,082,210</u>	<u>\$ (6,499,784)</u>	<u>\$ 5,054,317</u>	<u>\$ 21,636,743</u>	<u>\$ (4,978,125)</u>

The Partnership recognizes transfers into and out of the levels and securities indicated above at the end of the reporting period based on fair market value. Financial assets transferred between level 3 and level 2 were due to a change in observable and/or unobservable inputs.