



December 8, 2015

VIA Email

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RE: File Reference No. 2015-310, *Notes to Financial Statements (Topic 235) -- Assessing Whether Disclosures Are Material*

INTRODUCTION

The National Venture Capital Association (“NVCA”) represents the vast majority of American venture capital under management.¹ Venture capital funds invest across the spectrum of company stages of development, typically from early stage startup through IPO or acquisition. Over the past ten years, we have worked with the FASB on a variety of specific disclosure rule changes. Our consistent focus has been improving the quality and relevance of the notes to venture capital fund financial statements while delivering this information in a cost-effective manner.

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, 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 over 300 members through a full range of professional services. For more information about the NVCA, please visit www.nvca.org.

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GENERAL COMMENTS

We commend the FASB for undertaking the broad effort to improve the quality of disclosure. We commend this particular effort to change Topic 235 so as to enhance the effectiveness of disclosure in the notes to financial statements by encouraging preparers to exercise more discretion.² We recognize the difficulty of making such changes and the many factors that drive unnecessary disclosure like SEC rules, audit standards, auditor behavior, a litigious environment and overall resistance to change. The FASB has shown leadership and we encourage the Board to continue its efforts, even if this ED is only the beginning of a longer process.

Venture capitalists are both users and preparers of financial statements. Venture capital funds are nearly all private entities and the vast majority of fund investees are private companies. Therefore, our comments reflect both a user and preparer perspective and our experience in the varied universe of private entities.

Preparer discretion is especially important to private companies. As investors, venture capital funds (“VCFs”) invariably receive the most useful financial information from their “portfolio companies” long before they receive audited financial statements. Similarly, VCFs report financial results to our limited partner investors (“LPs”) far sooner than we can present them with a full set of audited financial statement. Therefore, while we fully recognize the value of footnote disclosure and audited financials we think VCFs-as-investors and VCF limited partners would benefit from the ability of preparers to exercise more discretion regarding notes to their financial statements.

We recognize that the proposed revisions to Topic 235 are intended to affect decisions about information disclosed to all sorts of users and prepared by the full range of companies, public and private. While venture capital is a rather small FASB constituency, we hope we provide a reminder of the diversity of entities to which FASB standards apply and the importance of preparer discretion to apply those standards in ways that are most relevant to users of their financials.

This ED has already received comments from a variety of experts in accounting and auditing. Some comments raise uncertainty as to whether these proposed changes will significantly impact the ability of preparers to effectively exercise more discretion in

² We note the FASB’s recently proposed ASU would change Topic 820 disclosure requirements and look forward to submitting comments on that exposure draft.

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presenting information in the notes to financial statements. We also see that some commenters oppose any change in the rules that would have a practical effect on disclosure. We urge the FASB to pursue changes that have a practical impact.

As preparers, VCFs are required to include too many disclosures that are meaningless to LPs but, as a practical matter are mandatory. Investors pay the price in terms of VCF resources used and the need to wade through the clutter of confusing disclosures. Additional cost arises from the false sense of importance that irrelevant, but mandated disclosures convey. Furthermore, audit fees are normally paid by VCF LPs so investors also pay the price of having auditors review disclosures that are ineffective, but *de facto* mandatory.

Therefore, preparers and their auditors need the leeway to exercise greater discretion so that their disclosures are more effective and more relevant. Such discretion should also make audits more cost-effective. Therefore we support the goal of enhancing the exercise of preparer discretion and hope the final ASU for Topic 235 meets that goal.

SPECIFIC COMMENTS

Relevance

We have reviewed the discussion of "entity-specific relevance" in BC7 – BC10. We nonetheless believe that relevance is an appropriate consideration, at least in the private company context. Therefore, we recommend that "user relevance" be integrated into Topic 235 as an additional consideration in the exercise of preparer discretion. This could have a practical impact. For example, some disclosures required by Topic 820³ for Level 3 valuation estimates may be appropriate for evaluating metrics used for debt investments; however, these disclosures may actually be misleading when summary or aggregated disclosures relate to equity investments. This is particularly true when equity investments of a VCF have differing ownership percentages and differing leverage levels. Such aggregated disclosures do not provide

³ Topic 820-10-55-103 includes a table with a column for "weighted average" without any indication as to what the weighting is based upon. For a VCF including weighted average of a grouping of portfolio companies that might be valued on different EBITDA metrics (to determine enterprise value) which have vastly different leverage profiles and in which the fund has different ownership percentages gives meaningless information to the user while suggesting that such information is relevant when it is not.

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decision useful information for users, since there is insufficient context for purposes of evaluating the aggregated information. This information can also be distorted when such information is presented on a weighted average basis.⁴ The ability for preparers to determine that such disclosure is irrelevant to its users would make the remaining disclosures more effective.

In addition to the concern that the aggregated information in the existing required disclosures represents an inefficient use of time and effort in preparing summary level schedules, the greater concern is the inference that less sophisticated users might draw – that the summarized information is relevant and decision useful because it is mandated by GAAP. To the extent that the information is not decision useful and more relevant disaggregated information is being provided to users, preparers should have the discretion to omit such disclosures. This is consistent with paragraph BC39 of the Private Company Decision Making Framework, which states:

Because of the users' greater access to management and the often closer relationships between private companies and their investors and lenders, many preparers and users of private company financial statements said that there is less need for mandatory, extensive note disclosures in private company financial statements than in public company financial statements.⁵

Although it is generally true that limited partners of VC funds have greater access to the fund management than shareholders in public entities, it is also true that industry-standard supplemental disclosure to VC investors is significant and should be an important consideration in determining whether disclosures are required.

⁴ VC funds typically provide far more meaningful disaggregated information about their underlying investments outside the context of the financial statements. Such supplemental information can be voluminous and include extensive information about the portfolio and cannot be practically incorporated into the fund's financial statements.

⁵ Private Company Decision Making Framework, page 42. Available at http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176163703583&acceptedDisclaimer=true.

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Defining "Materiality"

We understand the Board's desire to clarify that materiality is a legal concept and that GAAP should not contain a conflicting definition. However, we are concerned that the ASU's treatment of the issue will lead to ambiguity and preparers may question their ability to apply the materiality standard without involving lawyers. Therefore, we endorse the suggestion made in other comment letters⁶ that the final ASU re-state or paraphrase the legal definition of materiality in order to avoid the suggestion that lawyers are needed. Given the durability of the current legal definition it does not seem likely that the FASB would need to revisit Topic 235 very often to address a change in the law.

Conclusion

We once again commend the Board their efforts to improve the notes to financial statement by enhancing the use of discretion by preparers. This project has the potential to make a real difference, or to at least begin a process that will make a difference in the quality of the information available to users. The FASB should be careful that its final ASU will make a practical difference. It should study the comments letters that recommend constructive changes that will help ensure that result. Change is needed, and the Board should not squander its significant efforts on a new standard that accomplishes little actual improvement toward more meaningful disclosure.

NVCA appreciates the opportunity to comment. We stand ready to work with the Board and the staff on this and other important matters. Please feel free to contact me at 202 864 5925 or bfranklin@nvca.org or Justin Field, Vice President of Government Affairs at 202 864 5929 or jfield@nvca.org.

Sincerely yours,



Bobby Franklin
President & CEO

⁶ See e.g., Comment Letter of Dennis R. Beresford, dated October 22, 2015, page 4. Letter number 7 available at http://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&pr object_id=2015-310.