NATIONAL VENTURE CAPITAL ASSOCIATION
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**VIA Email**

Technical Director
File Reference No. 2016-370
FASB
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Re: Distinguishing Liabilities from Equity (Topic 480)

As the voice of the venture industry, the National Venture Capital Association (NVCA) appreciates the opportunity to comment on the Proposed ASU, *Accounting for Certain Financial Instruments with Down Round Features and Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception.* NVCA members manage venture capital funds (VCFs) that invest in thousands of startup and early-stage companies each year. As such they are the primary users of their portfolio companies' financial statements. VCFs often hold securities with down round features and are therefore users of financial statements whose preparers are required to report on the impact of down round features on their financial condition. VCFs also naturally invest in down rounds.

NVCA appreciates the Board's efforts to simplify the accounting for instruments with down round features. However, we encourage the Board to take steps to simplify these rules beyond the changes in this Proposed ASU. We believe that further simplification will deliver more decision-useful information to users such as VCFs on a more cost-effective basis.

SPECIFIC COMMENTS

*QUESTION 1: Do you agree that when classifying certain financial instruments with down round features, the down round feature should be excluded from the assessment of whether an instrument is indexed to an entity's own stock (in accordance with the guidance in Subtopic 815-40)?*

We support excluding down round features in assessing whether an instrument is indexed to the issuer's own stock. However, we recommend further relief from the requirement to apply Topic 815, a change we think will better achieve the Board's simplification objective in this context. As we read the Proposal, the remaining requirements to apply Subtopic 815-40 on Derivatives and Hedging would remain a significant reporting burden for no benefit. While an improvement over current accounting, the Proposal would still result in accounting that "does not reflect the economics of the down round feature"[1] because these features have no economic consequence to the reporting company.

Specifically, the Proposal says, "[a]n entity would still be required to determine whether instruments would be classified in equity under the guidance in Subtopic 815-40…."[2] Therefore, while the Proposal would eliminate some of the analysis required under current accounting, preparers would still be required to perform detailed analysis using the "extensive and complex"[3] derivatives accounting literature.

The results of this proposed analysis and its equity-liability classification of instruments with down round features are inconsequential to VCF investors. Until a down round provision is triggered, VCFs do not concern themselves with their hypothetical impact. While we understand the theory and intent behind the exercise that would be required under this Proposal, we do not see any practical information

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[1] Proposal at page 1.
[2] *Id.,* page 3.
[3] *See* "What Management should know before issuing equity-linked instruments in financing transactions*."* Faye Miller, Partner, National Professional Standards Group, RSM US LLP (January 2016), pages 11-15 and page 21 ("the guidance related to the accounting for equity-linked financial statements is extensive and complex. In many cases, the outcome can be affected by the existence or absence of a one sentence in the relevant documents.") *See also*, the Appendix thereto at pages 22-23. Available at http://rsmus.com/pdf/equity_linked_instruments_financing_transactions.pdf.

resulting. Therefore, we would prefer a simple scope exception for private companies so that the resources required to make the proposed analysis can be directed to more useful purposes.

*QUESTION 2: Do you agree that for certain financial instruments with down round features, the effect of the down round feature should be recognized when it is triggered and that the approach for recognition should follow the classification (liability or equity) of the instrument?*

We do not agree with recognition of the triggering of a down round feature through changes to equity. When a down round feature is triggered in a company, the result is a theoretical transfer of value between shareholders. The finances of the company are not affected. The Proposal, on the other hand would reduce the company's retained earnings. Since no diminution of the company's ability to pay dividends results from this theoretical transfer of value between shareholders, we see no reason to require recognition of this event in the company's retained earnings.

The Proposal also misses the point that any down round feature is part of a security when it is issued. Therefore, the triggering event does no more than crystallize how much value the shareholder with down round protection obtained from other shareholders. This result is fully anticipated by a VCF that is investing in a down round. It would be appropriately included in disclosures.

In any event, the economic consequence of the down round is absorbed by shareholders and should not affect the company's financial statements. The company should be required to make some basic disclosure in the Notes when the down round feature is triggered, not through artificial entries on the company's financials. Therefore, for the sake of accurate reporting, the Proposal should be modified. Furthermore, since the effect of these changes will be felt most profoundly by private companies, the FASB should, at a minimum consider a private company exemption from requirements to do any more than disclose that a down round feature has been triggered in the Notes to Financial Statements.

Conclusion

NVCA appreciates the opportunity to comment on this Proposal from the user's perspective. We hope our comments help the FASB provide useful financial information regarding down rounds while reducing undue complexity and cost. We stand ready to assist the FASB in any way we can. 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,

Bobby Franklin

Bobby Franklin
President and CEO