



PCPS

PRIVATE COMPANIES PRACTICE SECTION

January 4, 2006

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Ms. Suzanne Bielstein, CPA
Technical Director-File Reference No. 1235-001
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: September 30, 2005 FASB Invitation to Comment, *Selected Issues Relating to Assets and Liabilities with Uncertainties* (Project No. 1235-001)

Dear Ms. Bielstein:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the invitation to comment and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC appreciates the Board's effort to address the issues of uncertainty and probability as it updates the conceptual framework for defining, recognizing and measuring assets and liabilities.

However, TIC cannot support the ITC as written. The accounting model presented for assets and liabilities that contain uncertainties would not improve the financial reporting of balance sheet elements. In TIC's view, it is not workable and would not be embraced by the lender community for private companies.

TIC understands that improvements are needed in the accounting for uncertainties in financial statement elements and encourages the Board to continue its research and deliberations. However, TIC believes that any new approach to recognition and





measurement has to have some minimum recognition threshold for assets and liabilities that is based on probability. TIC believes estimates of probability have served us well in the past, and has received no indication that financial statement users are demanding major change that approaches the model suggested in this ITC.

SPECIFIC COMMENTS

A concepts statement based on this ITC would create many new assets and liabilities, representing previously unknown unconditional rights and obligations, recorded at amounts having high variability over time. In effect, this would shift a large part of the accounting model from performance-based reporting to value reporting.

Pervasive fair value reporting would include greater variability and more subjectivity that might be very appealing to certain equity participants, but significantly less appealing to lenders. Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises*, concludes that general purpose financial reporting should be “directed toward the common interests of many users” [paragraphs 28-30]. As such, the information should be useful to a broad range of users, who would use the financial statements for varied purposes—not just equity investing. The Board has not demonstrated how the value reporting model would improve the lender’s ability to make credit decisions since the values derived are neither more reliable nor more useful than our current model.

In particular, the new rights and obligations that would be recognized on the balance sheet would not be meaningful to most users of our constituency’s financial statements. The examples of unconditional elements given in the ITC are not recognized business assets and obligations to which business people ascribe value. Therefore, recognizing values for them in financial statements would not serve any useful purpose. The unconditional nature of these elements is highly subjective – both in terms of how they would be identified and how they would be measured. The introduction of these elements would further sacrifice reliability for the sake of fair value reporting and would not be acceptable to most users of private company financial statements for that reason alone.

The accounting model presented in the ITC will not be a sound basis for a concepts statement. TIC members did not find many of the Board’s arguments to be persuasive and also concluded that the ITC is internally inconsistent and overly complex. , On the one hand, it argues for non-recognition of contingent assets and liabilities. At the same time, the end result of the proposed accounting is recognition and measurement of contingent financial statement elements. For example, if a stand ready (nonconditional) service obligation exists, for which no directly observable market price is available, the Board concludes:

...the amount an entity would expect to pay to settle the service obligation



(i.e., stand ready obligation) would reflect the likelihood, amount and timing of the expected cash flows attaching to the conditional obligation.

[Source: Paragraph BC80]

TIC believes a more effective way to achieve this result would be to change the definition of assets and liabilities to allow for limited recognition of contingent elements.

TIC would agree that current definitions of assets and liabilities in the conceptual framework are inconsistent with the recognition of either contingent assets or contingent liabilities. The definitions pre-suppose a level of control on the part of the entity that cannot exist when there is only a possibility of obtaining a resource or incurring an obligation. TIC would argue that the answer lies in revising the definition of assets and liabilities rather than artificially assigning nonconditional features to conditional elements.

TIC believes the definitions of assets and liabilities should be parallel and consistent. Both assets and liabilities should be held to the same recognition and measurement standard. The ITC says the existence of assets and liabilities should be established as a pre-condition to recognition or measurement. TIC generally agrees with this statement, but the determination of an asset or liability's existence needs to come from an improved definition of these elements.

TIC disagrees with the IASB theory and would argue that probability has a role in a recognition model and that the Board should establish a minimum recognition threshold for assets and liabilities, both at inception and incrementally. TIC believes this would add to the reliability of the numbers and help users to better assess the enterprise's future cash flows.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Edward J. Knauf, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees