

Letter of Comment No: 7
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WILLIAM J. HUPP
PARTNER - CFO

312.553.7877
Fax 312.553.7891
whupp@adamsstreetpartners.com

Mr. Lawrence W. Smith
Chairman of Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

File Reference No. EITF0405 and FSPSOP78-9-a

Dear Mr. Smith:

Adams Street Partners appreciates the opportunity to provide our views on the impact of proposed EITF Issue No. 04-05, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights," and the related FSP SOP 78-9-a on what we view as long standing accounting practices in the investment management business. We understand that others, including the National Venture Capital Association, will be submitting comments reflective of our concerns for the venture capital and private equity industry as a whole. Adams Street Partners would like to offer additional comments based on the impact of the proposed rules on our business operations and the usefulness of the changes to our advisory company financial statements for our banks, lessors and owners.

Background

Adams Street Partners is a registered investment advisor, providing investment advisory services to clients who wish to pool their investment assets with those of other investors. We have provided discretionary investment advice for our clients on a separate account basis and through a variety of investment vehicles, including collective trusts, offshore trusts and limited partnerships. From our beginning as a part of First National Bank of Chicago through our current status as an independent registered investment advisor, we have operated as a fiduciary for our clients. In general, our clients are institutional entities, often operating under ERISA or similar regulations in their countries. At their request, Adams Street Partners, the operating management company, is both investment advisor and general partner for the current investment vehicles we advise.

Our current ownership structure consists of a majority of our employees, as partners, and our former parent UBS as a minority owner. The financial statements of our

management company are currently used by the partners and UBS as owners, by our bankers and lessors, and occasionally by our investors who may inquire as to the current equity structure and capitalization before committing to a long term investment with us.

Impact on Adams Street Partners

Consolidation of the limited partnership financial statements with those of the advisor who also serves as the general partner results in financial statements for Adams Street Partners that do not represent the underlying economics. Consolidation results in a balance sheet with investment assets for which Adams Street Partners will not benefit together with minority interest close to 100% of the value of these assets. It is unclear how revenues and expenses would be presented. If eliminated in consolidation our key revenue number, management fee income, would not be presented. If the income statement were to be grossed up, the other consolidating items would dwarf management fee income.

We have discussed the impact of the proposed changes from the EITF with our financial statement users. Our bank has indicated that they are not in favor of the change and would request that audited supplemental consolidating schedules be provided. Our lessor is interested in our current equity position, our outstanding commitments, and our current cash flow. All of these numbers would require explanation if presented in a consolidated financial statement. As owners, our partners have also indicated that they would find the changes meaningless. They are interested in the performance and financial status of the advisor entity alone. We also have concerns that our clients, for whom we act as a fiduciary, will have concerns about what they perceive as their assets being on our balance sheet.

Practical Consolidation Issues

As one of the founders of private equity fund of funds partnership investing, we manage more than 100 pooled investment vehicles. Many of these are investment limited partnerships, but others are organized as collective trusts and offshore trusts. We foresee problems with the sheer quantity of limited partnership entities to consolidate and are also troubled with the lack of consistency of consolidating limited partnerships but not other similar trust and offshore investment vehicles.

Consolidated financial statements would also be less timely. The majority of our investment partnerships produce financial statements 90 days after the end of the period, as they must generally wait until they receive financial statements from the partnerships they are invested in. Therefore, our audited financial statements for the management company would be delayed by at least 3 months or alternatively would need to be on a basis different from the consolidated partnership information.

Both the complexities and timeliness issue noted above would force us away from using generally accepted accounting standards in the normal operation of the business. Our

users would have to rely on unaudited unconsolidated financial statements in order to receive timely information. Consolidated GAAP reporting would become merely a compliance issue. As Adams Street Partners grows, I predict consolidated reporting would ultimately be dropped when it becomes too onerous.

Kick-out rights

Kick-out rights, also referred to as “no fault divorce” provisions, are a standard part of the legal agreements in the formation of new investment limited partnerships. Older limited partnerships, some formed more than 10 years ago, may not have such provisions. These provisions often require a supermajority of 67% to 80% to replace the general partner.

While such rights for the limited partners have become standard, they are only one of a number of provisions that are negotiated as part of a limited partnership agreement between sophisticated institutional investors and the advisors to the partnerships. Of equal importance in protecting the rights of the limited partners are key-man provisions, liquidation rights, and distribution rights.

Key-man provisions insure that the investment manager making the investments in the fund are the same people who produced the previous fund’s track record. Liquidation rights provide for a fund to be liquidated when the investment manager strays from any of a number of specific investment guidelines that have been agreed to prior to the commencement of investment operations.

FSP No. SOP 78-9-a Example 3 indicates that “rights to block customary or expected . . . distributions may be substantive participating rights. . .” It is customary for both the size and timing of distributions to be spelled out in detail in the limited partnership agreement. This is seen as the one of the strongest protections for the limited partners.

A control model that places all the emphasis on simple majority kick-out rights as the first test to pass does not appear to be consistent with the legal structures and negotiated rights that exist in the current private equity marketplace. Supermajority kick-out rights alone should not be evidence that the general partner has control. We believe that a control model that allows for a broader view of limited partnership rights would better reflect the economics of the fund formation process.

I appreciate the opportunity to comment on this EITF Issue. It is critical for the effective operation of our capital markets for accounting standards to fit the needs of the users of those financial statements. For Adams Street Partners and its financial statement users, I believe consolidation of the limited partnerships would negatively impact the usefulness of GAAP compliant investment advisor financial statements.

If I can offer any further clarification as to the impact on our firm please feel free to call me at 312-553-7877.

Very truly yours,

William J. Hupp
Treasurer and Chief Financial Officer