

International Association of Consultants, Valuators and Analysts

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Financial Accounting Standards Board 401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116
By email: director@fasb.org
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Madam, Gentlemen,

This letter of comment is submitted on behalf of the International Association of Consultants, Valuators and Analysts (IACVA), a member of the International Valuation Standards Council (IVSC) and the World Association of Valuation Organizations (WAVO). We are a knowledge transfer and credentialing organization with Charters covering 54 countries serving about 12,000 members who are mainly involved in business valuation and fraud deterrence.

As a worldwide organization, we are extremely concerned with the development of the accounting standards related to valuation especially in Canada (an IFRS country), where we are incorporated, as well as in the United States, which has, at the moment, a majority of our members.

We appreciate the opportunity to comment on the FASB Discussion Paper "Private Company Decision-Making Framework". Our responses to the Questions for Respondents are as follows:

Question 1: Please describe the individual or organization responding to this Invitation to Comment. a. Please indicate whether you are a financial statement preparer, user, or public accountant, or if you are a different type of stakeholder, please specify. Please indicate if you are both a preparer and a user of financial statements.

Our members are mainly CPAs involved in the valuation of businesses, business interests, assets and technologies. As such, they could be in any particular situation, a preparer, user or public accountant.

b. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your business and its size. If applicable, describe any relevant prior experience in preparing financial statements for private companies or public companies.

Most of the entities being valued by our member are privately held, including both C and S corporations, family limited partnerships, limited liability companies, various other forms of partnerships and sometimes, sole proprietorships.

c. If you are a user of financial statements, please indicate in what capacity (for example, investor or lender) and whether you primarily use financial statements of private companies or both private companies and public companies.

The value of any business, business interest, asset or technology is, in general, dependent on the future cash flows that will arise from its ownership. In analyzing the financial statements of privately owned entities, those of comparable publicly traded enterprises are often used as guidelines.

d. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on private companies or both private companies and public companies.

Our members' firms range from the "final four" to sole practitioners.

Question 2: Has the staff identified and focused on the appropriate differential factors between private companies and public companies (see paragraphs DF1–DF13)? If it has not, please explain why and include additional factors, if any, that you believe should be considered along with their potential implications to private company financial reporting.

The first five of the following six factors identified by the staff should be considered in the definition of a private company; in our view, the sixth is irrelevant.

- I. Types and number of financial statement users
- II. Access to management
- III. Investment strategies
- IV. Ownership and capital structures
- V. Accounting resources
- VI. Learning about new financial reporting guidance.

In addition, we would add liquidity in the sense that the holder of shares of a publicly traded entity (except for an insider) can normally buy or sell such an investment almost immediately with settlement within a few days for a reasonably nominal cost. The sale of a business interest in a privately owned entity requires substantial time, effort and expense. In our view, this characteristic is the most important differentiation. The information required for normal operations of private companies is considerably less than that needed for a sale. The information needed for a purchase and sale of publicly traded business interest is required constantly and normally supplied by quarterly and annual reports under SEC regulations.

Question 3: Overall, do the staff recommendations result in a framework that would lead to decisions that provide relevant information to users of private company financial statements in a more cost-effective manner? If they do not, what improvements can be made to achieve those objectives?

We strongly disagree with the statement in paragraph 2.2 of the "Preliminary Staff Recommendations" that "Generally, the Board and the PCC should require private companies to provide the same disclosures as public companies for industry-specific accounting guidance that relates to one of a private company's significant businesses because of the presumption that, generally, industry specific disclosures are relevant to financial statement users of both public companies and private companies operating in those industries" We do not believe this presumption is supported by facts.

Overall, the staff framework seems to require nearly as much disaggregated information for private companies as for their public counterparts rather than a reasonable minimum necessary for credit purposes. In our view, the staff recommendations do not result in a "framework that would lead to decisions that provide relevant information to uses of private company' financial statements in a more cost effective manner".

We suggest the emphasis in financial statements for private companies should be, on the entity's cash generation capabilities, rather than the Balance Sheet which is the focus of many recent changes to GAAP; for example this would involve junking the concept of deferred income taxes taking into account only cash taxes paid.

We believe net income is not as important as cash flows for privately owned entities. As lenders, the major users of such statements, are also concerned with assets that could be sold, we recommend full information about the entity's financial, physical and intangible assets be set out in the Notes, perhaps as a supplementary fair value balance sheet taking into account all costs and taxes due on any sales.

Question 4: Do you agree that private companies that apply industry-specific accounting guidance generally should follow the same industry-specific guidance that public companies are required to follow because of the presumption that guidance is relevant to financial statement users of both public companies and private companies operating in those industries? If not, why?

Our view is that it depends on the entity's size. Much industry-specific guidance is based on large publicly traded enterprises with a number of subsidiaries. Most (but of course, not all) privately owned firms are what are described as SMEs (Small and Medium sized Enterprises) having less than 500 employees, revenues of under \$100 million and operating on a state or regional, rather than national, basis. National firms should be subject to similar industry specific disclosures as publicly traded enterprises. Those operating on a lesser scale should be allowed to choose either the industry specific rules, or normal private company GAAP, based on which of them the firm's public accountant feels best express the objectives of the financial statements such as disclosure of cash flows allowing the user to reasonably estimate future expectations, plus information relating to existing assets of all classes.

Question 5: Do the different areas of the framework appropriately describe and consider the primary information needs of users of private company financial statements and the ability of those users to access management, and does the disclosure area of the framework appropriately describe the *red-flag approach* often used by users when reviewing private company financial statements (see paragraphs BR43 and BR44)? If not, why?

As set out previously, we believe the requirements of private company financial statements should be oriented to cash flows and reflect the results of each of the three sets of activities found in nearly all businesses: "existing operations", "emerging activities" and "future opportunities". The degree of disclosure should reflect their relative importance; we find no mention of these factors in the framework.

With respect to the red flag technique (not approach), we believe it is in common use and that most users of financial statement of privately owned entities will have enough existing knowledge to be able to rely on reduced disclosure. We do not believe that the proposed framework should be based on the limited number of users that (per BR45) "may have a greater need for more comprehensive notes".

Question 6: Has the staff identified the appropriate questions for the Board and the PCC to consider in the recognition and measurement area of the framework (see paragraphs 1.5 and 1.6)? If it has not, why, and what additional factors should be considered?

We concur with the importance of the first group of questions set out in paragraph 1.5 that pertains to the relevance of information to typical users of private company financial statements and the access that those users commonly have to the relevant information:

- a) Does the transaction, event, or balance affect reported cash balances, cash flows, or adjusted EBITDA?
- b) Does the transaction, event, or balance significantly affect borrowings, liquidity, or leverage?
- c) Does the transaction or event affect, or does the balance relate to, trade receivables, inventories, fixed assets, other long-term tangible assets, accounts payable, or other liabilities?
- d) Do users typically consider the quantitative effect of the transaction, event, or balance when evaluating collateral, financial performance, or financial position? Consider whether users typically adjust financial statements by substituting an alternative accounting approach.
- e) Is the primary purpose of the guidance to provide information about historical events and transactions rather than to provide information with predictive value to help users in making their forecasts of future cash flows?
- f) Does the guidance require that the threshold for recognizing or measuring a transaction or event be at least probable of occurring?

- g) Does the guidance relate to loss contingencies or commitments that could significantly affect future cash flows? If yes, consider whether disclosing the event or circumstance would likely satisfy the needs of users.
- h) Does the measurement guidance reflect volatility in financial statements resulting from underlying changes in market prices of debt instruments or certain derivatives that can reverse in the future because the instrument or derivative has a defined maturity or term?
- i) Is it likely that users that are interested in the transaction, event, or balance can obtain information directly from management that can reasonably satisfy the objective of the guidance?
- j) Is an untimely issuance of financial statements likely to dilute significantly the relevance of the information resulting from the guidance?
 - With respect to the second group of questions set out in paragraph 1.6 that pertains to the cost and complexity of providing information to users of private company financial statements we would suggest that any requirement that results in the answer "yes" to any of them should not be applied to financial statements of privately owned entities:
- k) Does application of the guidance often require assistance from outside resources at a significant cost?
- I) Is significant complexity involved in determining the initial and/or ongoing accounting treatment?
- m) Are there expected to be significant changes to information systems, debt covenant agreements, other contracts, internal controls, or processes due to the application of the new guidance?
- n) Is the accounting treatment challenging to audit, review, or compile?

Question 7: Has the staff identified the appropriate areas of disclosure focus by private company financial statement users for the Board and the PCC to consider (see paragraph 2.8)? If it has not, why, and what additional areas of disclosure focus should be considered?

With respect to the list set out in paragraph 2.8 that describes common areas of focus by typical users of private company financial statements we believe that only items a, b, c, d, g and j should prevent an exemption or modification of GAAP disclosure:

- a) Cash balances, current or future cash flows, and adjusted EBITDA
- b) Borrowings and other credit obligations, liquidity, or leverage
- c) Significant contingencies and commitments affecting future cash flows

- d) Significant events and transactions affecting cash flows that are unusual in nature or that occur infrequently
- e) Noncash charges relating to trade receivables, inventories, fixed assets, and other long-term tangible assets
- f) Information about which entities are included in the consolidated financial statements and the reasons for any changes to the company's policy about which entities are included in the consolidated financial statements
- g) Capital, regulatory, or other contractual restrictions that may affect future cash flows or liquidity
- h) Material transactions with related parties
- i) Information about restatements or prior-period errors that have a material effect on the comparability of financial statements
- j) Material subsequent events
- k) Significant changes in accounting principles, policies, and estimates
- Information about whether an alternative method of accounting guidance has been applied
- m) Other events and circumstances that could significantly affect future cash flows.

Question 8: Do you agree that, generally, private companies should apply the same display guidance as public companies? If not, why?

We do not believe that any display guidance is needed for private companies due to users' ability to access management.

Question 9: Do you agree that, generally, private companies should be provided a one-year deferral beyond the first annual period required for public companies to adopt new guidance? If private companies are provided a deferred effective date, do you agree that a private company should have the option to adopt the amendments before the deferred effective date for private companies but no earlier than the required or permitted date for public companies? If not, why?

We believe that any entity should have the right to introduce any changes to the Accounting Standards Codification (ASC) at its time of choice between the date it is approved up to the final effective date; the latter should be 12 months later for private companies.

Question 10: Do you agree with the staff recommendation that some circumstances may warrant consideration of different transition methods for private companies? If not, why? If yes, has the staff identified the appropriate considerations for the Board and the PCC to evaluate? If not, what additional factors should be considered?

We do not think that different transition methods are needed for private companies. The question is whether a particular item or procedure should be applied to an private company.

Question 11: Do you agree with the basis for the Board's tentative decisions reached to date about which types of companies should be included in the scope of the framework (see paragraphs B8–B23 in Appendix B)? If not, why?

We disagree with the Board's view set out in B6 (b) and (c). Any pass through entity for publicly traded debt securities is normally passive and its disclosures should not have to be the same as those for an entity issuing publically traded equity instruments.

An employee benefit plan is effectively the same irrespective of whether the relevant employer is an entity with publicly traded equity securities or one in which they are privately held; the relevant factors are size and scope. Therefore, their disclosures should not be determined by the nature of the sponsoring employer.

We also disagree with the Board's point of view with respect to financial institutions about which the applicable regulators are bettered informed than the Board. We prefer the alternate described in paragraph B18 relating to size thresholds. We feel the Board is being too protective by not being willing to delegate such criteria.

Question 12: Are there other types of entities that you believe the Board should specifically consider when determining which types of companies should be included in the scope of the framework (see paragraphs B6 and B7 in Appendix B)? If yes, please explain.

We believe that all Limited Partnerships, Limited Liability Companies and S-Corporations should be allowed to claim the standing of a private company.

Question 13: The staff acknowledges the importance of the decision to be reached by the Board and the PCC on whether to require a private company that elects to apply any difference in recognition or measurement guidance provided under the framework to apply all existing and future differences in recognition and measurement guidance. Below, the staff has included some initial observations raised by a limited number of stakeholders about this topic. The staff is seeking to obtain broader input to help inform the Board and the PCC as they further assess the implications of this decision.

Some users of private company financial statements stated that they prefer an *all or nothing* approach of applying recognition and measurement differences to achieve consistency within a private company's financial statements and promote comparability among the financial statements of private companies that choose to apply all exceptions and modifications provided under the framework. Those users indicated that such an approach would reduce the confusion that they may experience if private companies are allowed to select which differences they wish to apply. The users acknowledged that the extent of that confusion will depend on the number of recognition and measurement differences that are ultimately permitted and the nature of those differences. However, most of the users stated that they do not object to allowing private companies the option of applying some, none, or all of the permitted differences in disclosure, display, effective date, and transition method guidance.

Most preparers of private company financial statements acknowledged the concerns of some users, but stated that preparers should be allowed an option to select the differences provided under the framework that they wish to apply. Those preparers pointed to the possibility that not every permitted difference in recognition and measurement guidance may provide the most relevant information to users of their financial statements or for the companies operating in their industry. Some preparers also shared concerns about being required to make an initial commitment to apply all future differences permitted under the framework without knowing the nature or volume of the recognition and measurement differences that the Board and the PCC may ultimately provide.

a. Do you think that a private company that elects to apply any difference in recognition or measurement guidance should be required to apply all existing and future differences in recognition and measurement guidance? Please explain your response, including how you separately considered the benefits to preparers of private company financial statements and the effect on users of private company financial statements.

An all or nothing requirement would put users of private company financial statements in an information straight jacket. In our view, they should be allowed to choose those exemptions that, in the opinion of their Board of Directors, supported by their public accountant, that satisfy the needs of the users of their financial statements.

b. Do you think that a private company should have the option to choose which differences it applies in all other areas of the framework (disclosure, display, effective date, and transition method)? Please explain your response to the extent that you considered the benefits to preparers and the effect on users differently than you described in your response to Question 13(a).

See response to 13(a).

Should a Board or staff member wish to discuss this matter further, you may contact me from 9:30 am to 5:00 pm Eastern Time at 416-865-9766.

Respectfully submitted

for P. Cot

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James P. Catty, MA, CA•CBV, CPA/ABV, CVA, CFA, CGMA, CFE Chair