

USVP

U.S. VENTURE PARTNERS

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October 12, 2009

Technical Director
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
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**Re: Exposure Draft of a Proposed Accounting Standards Update
Fair Value Measurements and Disclosures (Topic 820)
Improving Disclosure about Fair Value Measurements
File Reference No. 1710-100**

Introduction and Background

Thank you for the opportunity to submit comments on the *Exposure Draft of a Proposed Accounting Standards Update, Fair Value Measurements and Disclosures (Topic 820), Improving Disclosure about Fair Value Measurements, File Reference No. 171-100* ("Exposure Draft").

U.S. Venture Partners ("USVP")¹ was formed in 1981 and has invested in more than 440 public and private companies in a wide variety of industries across a broad spectrum of the development stages of an enterprise, from start-up to expansion capital. The USVP funds have in excess of \$3.4 billion of committed capital and the investors ("Limited Partners") of these funds include a wide variety of institutional investors including insurance companies, financial institutions, pension plans, fund of funds, university endowments, and large private foundations.

Summary Comment

As is outlined in more detail below, USVP does not believe that the proposed disclosure of the effect of changes in reasonably possible, significant alternative inputs for Level 3 fair value measurements will provide meaningful data to the Limited Partners of venture capital funds, and believes that venture capital funds should be exempted from the requirement to produce such data.

USVP notes that on page 16 of the Exposure Draft in the example table entitled "Effect of Reasonably Possible Alternative Inputs for Fair Value Measurements Using Significant Unobservable Inputs", certain classes of investments, including investments in venture capital, have specifically been excluded from the disclosures called for under the Exposure Draft. We are hopeful the drafters of the Exposure Draft concluded such "sensitivity disclosures" were either not meaningful or not readily determinable, or both, for such investments.

As such, we urge the Board to exempt such investment vehicles from a requirement to produce such "sensitivity disclosures".

¹ U.S. Venture Partners and USVP are the names commonly used to refer to a series of venture capital partnerships and their related general partner and management company entities.

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Issue 1.1 – Comments Regarding Operationality and Costs

Operationality:

In our experience, the investments of a venture capital fund ("VC Fund") primarily consist of highly illiquid non-public securities of private companies, acquired directly from such private companies by direct negotiation with the issuer; such private companies are often times referred to as "portfolio companies". It is highly unusual, for example, for a VC Fund to buy (sell) the private securities of a portfolio company from (to) another VC Fund or any other financial investor, for that matter.

As such, VC Fund investments are nearly exclusively valued based on Level 3 inputs.

In most cases, there are three general methods for exit or monetization of a venture capital investment in a portfolio company. These include: (a) the successful initial public offering and related listing in a public market (such as NYSE or NASDAQ) by the portfolio company in which case the VC Fund's private securities are exchanged for public shares which may either be sold for cash in the public market or distributed to the Limited Partners of the VC Fund who in turn may sell the securities in the public market; (b) the acquisition of the portfolio company by another company in which case the VC Fund's holdings in the portfolio company are exchanged for cash or the public securities of the acquiror and such shares are liquidated as described above; or (c) the failure of the portfolio company to achieve its business development goals that were the basis for the VC Fund's investment premise at the time of the VC Fund investment, and the portfolio company is essentially shuttered, with assets sold, liabilities settled, and investors (including the VC Fund) typically receiving nothing more than "cents on the dollar invested".

Each of the exits described in (a) and (b) above are only achieved if the portfolio company is able to achieve the business goals that served as the basic investment premise. However, the time from investment to exit is typically years (evidence suggests that a typical early-stage investment requires upwards of 6 years to achieve an exit). Assuming quarterly reporting typical for VC Funds, this means that valuation must be estimated roughly 24 times before an exit is visible. And thus, the most basic questions (valuation assumptions) that are asked at each and every valuation point may be simplified as follows:

Is the portfolio company making acceptable progress toward the product development goals that serve as the investment premise?

Is there a likely acceptable market for the company's product?

If the answer to either of these questions is "No", then the portfolio company is more likely headed for the outcome described in (c) above, and realization / exit valuation is moving lower towards zero. If the answer to both questions is "Yes", then there remains a possibility to achieve the outcomes described in (a) and (b) above, though continuing effort is required.

For investments typical of a VC Fund, the "hope" and the "promise" of being able to achieve an (a) or (b) outcome drive valuation as much, if not more, than more objective variables such as discount factors, market multiples, interest rates, etc. Thus, in the most simplistic terms, the most significant alternative input becomes the answer(s) to these two basic questions.

It would be difficult to argue that a "No" could be rationalized to a "Yes". However, it is much easier to rationalize that a "Yes" could become a "No".

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Thus, in extremely simplistic terms, the sensitivity disclosures would suggest that there is no "increase in fair value", and that "decrease in fair value" would approximate the fair value itself.²

In our view, little additional information would be provided to the Limited Partners of a VC Fund by the proposed sensitivity disclosures. The primary and in many cases the only readers of the financial statements of a VC Fund are the Limited Partners of that specific fund. Further, we believe that VC Funds already include disclosures about the sensitivity of their estimates, as evidenced by the following excerpt from a VC Fund financial statement:

"While the General Partner believes its valuation methods are appropriate, the use of different methodologies or assumptions to determine fair value of investments in securities could result in a different estimate of fair value at the measurement date. Furthermore, the reported carrying values of investments in securities may not be reflective of and may differ materially from amounts realized upon the ultimate disposition of such investments in securities."

"The valuation of investments in securities categorized as level 3 requires significant judgment by the General Partner due to the absence of quoted market values, an inherent lack of liquidity, and the anticipated long-term nature of such investments."

"The inputs used by the General Partner in estimating the fair value of investments in securities categorized as level 3 include: the original transaction price; rights and preferences of the securities; recent transactions in the same or similar securities; completed or pending third-party transactions in the same or similar securities; subsequent rounds of financing by the issuer; recapitalization of the issuer; expected near term merger or acquisition of the issuer; significant changes in operating performance, future expectations, financial ratios or cash flows of the issuer; or market data consisting primarily of observations of the trading multiples of public companies considered comparable to the issuer."

Cost:

As suggested by *footnote 2* and as described in the 3rd paragraph of the excerpt from the VC Fund financial statement above, an extremely wide range of data points are considered in estimating fair value for the investments of a VC Fund. If the sensitivity disclosures suggested by the Exposure Draft were applicable to VC Fund, absent further detailed guidance in the Exposure Draft, the VC Fund and its auditors would be left with the task of interpreting and reconciling differences associated with identifying the data points to be subjected to modulation inherent in the sensitivity assessment process.

To a certain extent, one could envision a situation where the sensitivity analyses would triple the cost associated with the valuation of the VC Fund portfolio. Presumably, each portfolio company would be subjected to a revised valuation effort once for the incorporation of the effect of reasonably possible

² This is not to suggest that there can not or would not be other factors that would have to be considered that could result in a higher valuation of a portfolio, or that the downside would realistically equal the current fair value. By its very nature, the valuation of a VC Fund portfolio is not a science dependent upon specific variables plugged into a mathematical model, but an art dependent upon the interpretation of many subjective and relatively few objective data inputs.

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alternative inputs that decrease fair value, and a second time for the incorporation of the effect of reasonably possible alternative inputs that increase fair value. And each such effort would be subject to audit and the accompanying discussions and analysis to assess the reasonableness of each such assumption.

Considering the expectation that little additional information would be provided to the Limited Partners (the primary [sole] readers of the financial statements) and that the additional cost is likely passed on to these same Limited Partners, we conclude that the applicability of the sensitivity disclosures to a VC Fund would conflict with a basic tenant of Fair Value Measurements and Disclosures (Topic 820) which suggests that fair value measurements shall be based upon information this is "reasonably available without undue cost and effort" (ref 820-10-35-55).

Conclusion

As stated in the Summary Comment and for the reasons outlined in this letter, we strongly urge the Financial Accounting Standards Board to exempt VC Funds from the sensitivity disclosures that would be required under the Exposure Draft.

Thank you for the opportunity to submit these comments. If you have questions or require further clarification please contact me at 650.854.9080.

Very truly yours,



Michael P. Maher
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