



financial executives
international

COMMITTEE ON PRIVATE COMPANY STANDARDS

July 14, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Sent by email to director@fasb.org

File Reference No. 1770-100

Dear Mr. Golden:

The Committee on Private Company Standards (CPC-S) of Financial Executives International (FEI) wishes to express its views on the Financial Accounting Standards Board's (FASB's) Exposure Draft (ED) of a proposed Statement of Financial Accounting Concepts, Conceptual Framework for Financial Reporting: The Reporting Entity.

FEI is the leading advocate for the views of corporate financial management in the United States. It is a professional association of more than 15,000 CFOs, treasurers, controllers and other senior financial managers. CPC-S is a technical committee of FEI which formulates private company positions for FEI and reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations that impact private companies. This letter represents the views of CPC-S and not necessarily the views of FEI.

Presented below are responses to the questions asked in the ED:

Q1. Do you agree that a reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders, and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided? (See paragraphs RE2 and BC4–BC7.) If not, why?

CPC-S Response to Q1: We disagree with specifically listing “equity investors, lenders, and other creditors” in the definition of the reporting entity (see paragraphs S1 and RE2), for two primary reasons: 1) it might implicitly prioritize these users in the eyes of the reader, and 2) it leaves out certain non-creditor users, such as management and other employees. We suggest, therefore, that there is no need to specify any groups other than simply “users.”

We are also concerned that the definition limits users to those “who cannot directly obtain the information they need”. The most typical users of private company financial statements (e.g. bank lenders) can directly obtain most of the information they need simply by asking the company’s management for it. Therefore, we suggest that this phrase be removed, so that the definition won’t exclude this large subset of private company financial statement users.

We believe that the use of the broad term “economic activities” may have unintended consequences because the word “economic” is not defined. We suggest that the terms “business activities” or “operating activities” would be more appropriate. The proposed broad definition could result in consolidations that actually make the financial statements less useful, especially for users of private company financial statements.

Q2. Do you agree that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements? Do you agree with the definition of control of an entity? (See paragraphs RE7–RE8 and BC18–BC23.) If not, why?

CPC-S Response to Q2: For a private company, we believe that stand-alone, parent-only financial statements should be allowed to be presented, with appropriate disclosures, if that’s what a user of the private company’s financial statements wants. The fact that an entity controls one or more other entities doesn’t necessarily mean that consolidated financial statements will be the most useful presentation to a user. In our opinion, that determination is best left to each user (i.e. give them a choice). Professional judgment based on specific facts and circumstances should prevail. For example, a variable interest entity may hold a parent’s real estate, but it may hold other unrelated real estate and engage in other activities that have no bearing to a user who is a lender requiring collateral. In such cases, the consolidated information might have less meaning – either the “controlled” net assets are relevant to the parent’s cash flows and fair value or they are not. And, because of all of the aforementioned, the cost of preparing and auditing GAAP statements for these related parties exceeds the benefit obtained. An alternative would be to simply disclose in footnotes the relationship of the parent to the related parties and any risks to cash flows from the relationships.

Further, paragraph RE8 indicates that the focus of the consolidation requirement is the impact on cash flows to the parent entity. This seems to be an investment viewpoint, to the exclusion of other possible user viewpoints. For example, nothing is mentioned about providing enhanced information regarding operating performance or about using consolidated financial statements to determine the quality of earnings or performance of the controlled entities’ management. We believe such useful financial information can often be best provided in an unconsolidated presentation.

We disagree with the definition of control of an entity, as stated in paragraph RE7, because we believe it is too vague to be useful in the conceptual framework. Paragraph BC 11 states that the Board has intentionally defined control in “general terms.” We believe that a framework should clearly and specifically define the various terms to be used in the standards, and the standards should then be required to align with the framework.

Whereas using control as the sole determinant for whether to consolidate an entity may be appropriate for public companies because of the “economic” viewpoint of the users of their financial statements, we do not believe that control should be the sole determinant for private companies. Most users of private company financial statements (especially lenders) have a “proprietary” viewpoint, meaning that they apply a legal entity parameter to match the financial statements to their collateral and financial covenants. In light of these differences in user perspectives, we offer the flowchart attached to this letter as an alternative determinant for the consolidation decision which we believe is a better fit for users of private company financial statements.

Q3. Do you agree that a portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity? (See paragraphs RE6 and BC10.) If not, why?

CPC-S Response to Q3: We agree that a portion of an entity could qualify as a reporting entity, if the operating activities of that portion can be distinguished from the rest of the entity. However, we believe this view makes sense only if stand-alone, parent-only financial statements are also allowed to be presented (see response to Q2 above). It seems somewhat counterintuitive that the ED requires consolidation in the instance of entities under common control (paragraph RE8), whether their respective operations are complementary or disparate, while also stating that the existence of a legal entity is not sufficient to identify a reporting entity (paragraph RE4). We understand the ED to state that a portion of an entity can be a reporting entity, but a complete legal entity cannot be a reporting entity if it controls anything which might be, but isn't, consolidated with it. If our understanding is accurate, we disagree with that view with respect to private companies.

Q4. The FASB and the IASB are working together to develop common standards on consolidation that would apply to all types of entities. Do you agree that completion of the reporting entity concept should not be delayed until those standards have been issued? (See paragraph BC27.) If not, why?

CPC-S Response to Q4: We agree that the completion of the reporting entity concept project can occur prior to the issuance of common standards on consolidation, especially in light of our view that consolidated financial statements are not always the most useful.

We fully understand that control by a public entity (i.e., an entity whose financial instruments are registered on a public exchange) of another entity can affect the valuation of that public entity. However, private company financial statement users do not use external financial statements as a primary source of determining valuation of private companies -- as they can have free access to other financial information. Private company financial statements are by nature private. The purpose of external private company financial statements is to provide users with information (a) primarily about past operational performance of the company and the net cash flows that have and will be obtained from those past operations, and (b) secondarily to give an accounting of the resources invested into the private company by owners and lenders for the purpose of generating operational performance. While commitments made by a private company to other entities that might (i.e. contingently) result in future cash flows are important to users, these commitments are better disclosed in the notes of financial statements as to their nature and potential amount.

Private company users do not want the operational performance of the private company, nor its assets, many of which serve as collateral, nor its liabilities, many of which have stated maturity amounts and dates, obscured by the consolidation of entities that are not directly covered by user agreements made only with a single legal entity. A private company lender can certainly ask for separate statements of another related entity or even the personal financial statements of the owners as a condition of lending. Furthermore, assuming that the majority of the ownership of a private company agrees to another party gaining access to its financial information for purposes of valuation, then those majority owners will make available access to all of its financial information requested by the user or will negotiate access to such information. (Private company disclosures are not subject to regulation, and the right to disclose or not disclose remains the discretion of private parties.)

Applying the consolidation concepts in the ED to private companies in an effort to capture an "economic value" will result in providing less meaningful information to private company users for two reasons. First, the past operational performance, contracted collateral, and accountability of loaned and invested funds will be obscured. Second, the resulting consolidated "general purpose" financial statements will be a poor substitute for valuation purposes compared to other and better sources available to private company users who desire to make valuations. The substantial number of

responses that the FASB is continuing to receive from private company constituents regarding FIN 46R has confirmed our views.

Thank you for considering our comments. If you have any questions or wish to discuss this issue, please feel free to contact me at (918) 456-1472 or by email at dbuck@reasors.com, or Cheryl Graziano at (973) 765-1064 or by email at cgraziano@financialexecutives.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Daryl E. Buck". The signature is fluid and cursive, with a large initial "D" and "B".

Daryl E. Buck, Chair
Committee on Private Company Standards
Financial Executives International

Attachment

Flowchart - Reporting Entity

