



financial executives
international

COMMITTEE ON PRIVATE COMPANY STANDARDS

August 20, 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. 1840-100

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 of a Proposed Accounting Standards Update, *Contingencies (Topic 450): Disclosure of Certain Loss Contingencies* (the proposed Update).

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 in line with the views of the membership. 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 proposed Update:

Q1. Are the proposed disclosures operational? If not, please explain why.

Yes, CPC-S believes the proposed disclosures are operational. However, the proposal that entities provide information about contingencies with an outcome assessed as remote if the potential impact is severe is neither relevant nor timely for the overwhelming majority of private company users and, therefore, the substantial cost of preparing and auditing this information results in no meaningful benefit to the private company user. CPC-S does, however, appreciate FASB's removal of many of the speculative or predictive disclosures that were proposed in the June 2008 Exposure Draft, since this information is even more burdensome and irrelevant to private company users. Please see our additional comments regarding private company financial statement users below under Q6.

Q2. Are the proposed disclosures auditable? If not, please explain why.

Yes, CPC-S believes the proposed disclosures are auditable. However, the cost of obtaining and auditing remote contingencies with potentially severe outcomes is substantial to private companies who, because they are not subject to SEC regulations, otherwise do not engage in the extensive legal risk analysis and disclosure process required by SEC Item 1A, Risk Factors. Additionally, as explained further below under Q6, because of the nature of how private company users make investing and lending decisions, disclosure of remote contingencies with potentially severe outcomes is information that has clearly been demonstrated by the actions of private company users to be neither relevant nor timely to those decisions. There is simply no demand from private company

[1250 Headquarters Plaza](#) | [West Tower, 7th Floor](#) | [Morristown, NJ 07960](#) | [p:: 973.765.1000](#) [f:: 973.765.1018](#)

[1825 K Street, NW](#) | [Suite 510](#) | [Washington, DC 20006](#) | [p:: 202.626.7801](#) [f:: 202.626.6555](#)

FINANCIALEXECUTIVES.ORG

users for this information to be placed into external financial reports. Please see our additional comments regarding private company financial statement users below under Q6.

Q3. The June 2008 FASB Exposure Draft, Disclosure of Certain Loss Contingencies, had proposed certain disclosures based on management's predictions about a contingency's resolution. The amendments in this proposed Update would eliminate those disclosure requirements such as estimating when a loss contingency would be resolved and the entity's maximum exposure to loss. Do you agree that an explicit exemption from disclosing information that is "prejudicial" to the reporting entity is not necessary because the amendments in this proposed Update would:

- a. **Not require any new disclosures based on management's predictions about a contingency's resolution**
- b. **Generally focus on information that is publicly available**
- c. **Relate to amounts already accrued in the financial statements**
- d. **Permit information to be presented on an aggregated basis with other similar loss contingencies?**

If not, please explain why.

CPC-S agrees that an explicit exemption from disclosing information that may be prejudicial to the reporting entity is now not necessary; however, please see our additional comments regarding private company financial statement users below under Q6.

Q4. Is the proposed effective date operational? If not, please explain why.

See CPC-S's response to Q7.

Q5. Do you believe that the proposed disclosures will enhance and improve the information provided to financial statement users about the nature, potential magnitude, and potential timing (if known) of loss contingencies?

For users of public company financial statements, CPC-S believes the proposed disclosures will likely be an improvement over existing disclosures. However, for users of private company financial statements, CPC-S believes the proposed disclosures will not enhance and improve information because (a) the private company users can already obtain this information if they want it, (b) the information that private company users can obtain if they want it will be of a higher and more detailed quality, and (c) the information placed in external financial statements of private company users will not be timely and will likely be stale. Accordingly, the information is not worth the legal cost to produce and cost to audit in private company financial statements. Please see our additional comments regarding private company financial statement users below under Q6.

Q6. Do you agree that *nonpublic entities* should be exempt from the tabular reconciliation disclosures required in the amendments in this proposed Update? If not, please explain why. Are there any other aspects of the amendments that should be applied differently to nonpublic entities? If so, please identify and explain why.

Yes, CPC-S agrees that nonpublic entities should be exempt from the tabular reconciliation disclosures. We also believe that nonpublic entities should be exempt from disclosure of remote loss contingencies, because we don't believe such disclosure will add any appreciable benefit to our users. In general, CPC-S questions whether any of the proposed Update should apply to nonpublic entities, as stated in the following excerpt from our letter dated August 8, 2008, in response to the June 2008 Exposure Draft:

"Furthermore, the constituency requesting increased disclosure of loss contingencies is driven by investment analysts and others, who are attempting to value public companies. This is not the case for private companies as many private companies are not evaluated in

the same manner as public ones. Some private companies' stocks are not valued; others are based on formulas relating to business metrics including book value, net worth, etc. Ultimately, increasing loss contingency disclosure requirements will add more complexity, greater confusion and will result in increased cost without any appreciable benefit to readers of the general purpose financial statements.”

We see no evidence in the proposed Update that the FASB staff has performed due process in obtaining information from private company users to indicate that there is a demand for this information. There is, in fact, evidence to the contrary. Private company financial statement users are primarily bank lenders, existing owners/investors, and potential owners/investors.

Banks lenders typically insert into lending agreements a legal requirement for a private company to disclose a material adverse effect (MAE). Some of these MAE requirements are explicit and contain quantitative formulas. In our collective experience in working with these lenders, we have seen many of these agreements and are unaware of any such clause requiring disclosure of remote contingencies with severe consequences. In fact, the term “severe” is an FASB staff construct, not a term with which private lenders would be familiar. Additionally, lenders to private companies do not require general disclosure of risk factors as required for public entities, *when in fact they could*.

For potential investors in private companies, the process of becoming an investor is not dependent on the existence of audited GAAP financial statements (and, as we have mentioned elsewhere, is observed by many of us to create more and more frustrations and desires by private investors for “workarounds”). In the private company environment, potential investors perform legal due diligence that discovers potential legal claims, and in a manner much more extensively than an external auditor complying with GAAS. The public company investor acquiring shares in a market does not have this depth of access, and the proposed Update may be beneficial to this user. However, for the potential private company investor to rely on limited contingency disclosures in GAAP statements when there are more effective, relevant, and timely avenues would indeed be foolish. Private company audited GAAP financial statements based on accounting standards that purport to provide “improved” disclosures for the potential private investor could be a misleading claim.

We would also point out that, while CPC-S consists of financial executives of private companies, we are also users. Many of us use private company external GAAP financial statements as one piece of financial information obtained from other private companies in order to make investing, lending and other credit decisions. Some of us are active in mergers and acquisitions on our own companies’ behalf, and some of us are engaged by other parties, such as venture capital funds and private equity groups, to participate in such transactions and to perform due diligence for such transactions. As users, we see no added benefit to how we would use the proposed financial information for such decisions. We obtain better, more relevant, and more timely information than what the proposed Update would provide. We do not understand why *all* private companies should be forced to bear annually the added legal and audit cost of automatically including the information required by the proposed Update, which is tailored to the broad public company equity markets.

While we appreciate the exemption from requiring private companies to prepare the tabular reconciliation, the proposed Update provides contradictory explanations. The second part of your explanation for the exemption given in Paragraph BC31 reads that for private companies “the benefits of a tabular reconciliation may not justify the costs.” We point out that the costs of implementing the proposed Update are in the gathering of the underlying information, the legal costs of working with attorneys to craft a disclosure, the costs for having attorney’s communicate with auditors, and the additional audit costs. Once these costs are incurred, the cost to create a subsequent “reconciliation” is insignificant. We also note that the statement in Paragraph BC31, contradicts your statement in Paragraph BC51 that reads:

“[T]he Board believes that many entities already have the information necessary to fulfill those disclosure requirements and that including the information would not require substantial additional cost or effort.”

We point this out because we have noticed a pattern in recent standard setting whereby, for private companies, the Board has reduced some tabular disclosure requirements and has also provided one-year delays in implementation. However, the contradictory language of Paragraphs BC31 and BC51, along with the lack of evidence presented in the proposed Update that private company users are requesting the proposed disclosure requirements, makes us wonder if such a practice has become perfunctory. While we appreciate the Board’s practice in providing differential disclosure, we do not see evidence that the Board is giving consideration to the relevance to private company users regarding recognition and measurement. We applaud the Board for reaching out to private company constituencies, but we question, in light of substantial, sustainable responses from many private company constituents, how long the Board will hold to a one-size-fits-all policy, instead of recognizing the differential needs of private company financial statement users. We note that this proposed Update and other proposed standards are satisfying and improving the differential needs of a certain category of public company financial statement users, but responses from private constituencies indicate these new standards are harming the differential needs of private company users.

Q7. The amendments in this proposed Update would defer the effective date for nonpublic entities for one year. Do you agree with the proposed deferral? If not, please explain why.

CPC-S appreciates the proposed deferred effective date for nonpublic entities. However, as stated in FEI’s letter to FASB’s Chairman Herz dated July 22, 2010, we are concerned about the coordination of effective dates for new pronouncements, such as the proposed Update, with the effective dates of any enacted recommendations of the AICPA/FAF/NASBA Blue-Ribbon Panel on Standard Setting for Private Companies. Therefore, for the reasons outlined in FEI’s letter, CPC-S recommends that FASB defer for a minimum of three years the effective date of the proposed Update for nonpublic entities. Also, as stated in the letter, we recommend that FASB should provide an option for early adoption (i.e. on the same effective date as public companies) to nonpublic entities that might prefer to decline the deferred effective date.

Q8. Do you believe that the proposed and existing XBRL elements are sufficient to meet the Securities and Exchange Commission’s requirements to provide financial statement information in the XBRL interactive data format? If not, please explain why.

This question is not applicable to CPC-S.

Thank you for considering our comments. If you have any questions or wish to discuss this letter, please feel free to contact me at (918) 456-1472 or by email at dbuck@reasors.com, or Lorraine Malonza at FEI (973) 765-1047 or by email at lmalonza@financialexecutives.org.

Sincerely,



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