MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Raichilson (ext.443), Mechanick (ext. 301), Glotzer (ext.212)
Subject:	Minutes of the November 2, 2010 Private Company Reporting Issues Roundtable
Date:	December 7, 2010
cc:	Bielstein, Chookaszian, Posta, Klimek, Gabriel, Lott, Donoghue, Farber, Catalano

<u>Topic</u>: Public Company Reporting Issues

<u>Basis for Discussion</u>: Agenda (Attachment A), Topics of Interest

<u>Length of Discussion</u>: 9:00 a.m. to 12:00 p.m.

<u>Attendance</u>:

Board members present:	Linsmeier, Smith
Board members absent:	None
Staff in charge of topic:	Mechanick, Glotzer
Other staff at Board table:	Catalano, Raichilson
Outside participants:	See Participant Listing (Attachment B)

Summary of Decisions Reached

The FASB held this public roundtable discussion with constituents to discuss financial reporting issues pertaining to private companies. Participants and members of the Board discussed their views. No decisions were reached.

Objective of the Meeting

The objective of this meeting was to provide information to assist the Board in better understanding the general concerns of private company constituents, and to contribute to the Board framework for developing future standards.

Matters Discussed

ISSUE 1: DEFINING THE USE OF PRIVATE VS. PUBLIC COMPANY FINANCIAL STATEMENTS

1. Mr. Mechanick began the discussion by outlining the agenda for the roundtable, which included a discussion about the uses of private versus public company financial statements, followed by a more specific application to existing standards, including FIN 46(R) and FIN 48, ending with a discussion on fair value measurement.
2. Mr. Smith stated that his goal for this roundtable was to better understand the private company needs and costs associated with accounting standards, and to incorporate that understanding in the standard-setting process. He noted that many of the concerns previously raised by private companies are shared by public companies as well, and it is useful to distinguish issues that pertain only to private companies. Mr. Linsmeier agreed with Mr. Smith's acknowledgement of the importance of understanding private companies' needs and costs associated with standard setting.
3. Mr. Mendelson described his use of financial statements from the perspective of a venture capital (VC) provider, which involves preparing financial statements for the limited partner investors as well as analyzing the financial statements of current and potential investments. He mentioned the massive fiscal size of the venture capital industry as compared to the small number of people in it, and how the complexity of the standards requires venture capital firms to inefficiently employ a large number of accountants. Mr. Mendelson also noted that he views access to management as the primary difference between private and public companies. He stated that he uses financial

statements, in part, to determine if he is interested in investing in a company, but the personal relationship is where he gathers the most significant information. This concept also applies to investors of his fund.

4. Mr. Jones agreed with Mr. Mendelson and stated that personal relationships are a key component of their banking model. He stated that Silicon Valley Bank (SVB) will lend to companies three years before they become profitable, and they will often remain with those companies through the final exit plan, which is often an acquisition by a major software company. He mentioned a variety of companies that SVB lends to, including the venture capital firms themselves, which often entails funding the VC firms before their initial calling of capital from limited partners. Therefore, SVB uses financial statements at both the individual level and the fund level. He stressed that financial statements are used as only one data point and do not predicate any decision. Another data point is access to management and investors (for VC funds), and the financial statements are used to develop targeted questions for management and/or the investors.

5. Mr. Mechanick asked Mr. Jones if he always requires GAAP financial statements. Mr. Jones responded by stating that while they do not always require GAAP financials, particularly for early-stage companies, they often benefit from a VC firm requiring GAAP financials.

6. Mr. Smith recapped that he heard that a differentiating characteristic of private companies is their access to management and the fact that the SEC does not restrict the information they can receive from management. He noted a prior discussion with Mr. Delametter of QuikTrip Corporation regarding the complex capital structure of his company, consisting of an employee stock ownership plan (ESOP), along with two other classes of equity. This results in over 4,000 shareholders and, because of this, QuikTrip reports similarly to public companies. Mr. Smith asked what kind of access these shareholders have to management.

7. Mr. Delametter noted that because of the numerous shareholders in the ESOP plan, they produce consistent quarterly and annual GAAP financial statements. However, the primary users are still the banks. He noted that even with a sophisticated group of users, he has to explain his derivative footnote to his board members, the stockholders, and the banks, because they are so complex. He mentioned that users believe there is limited use

for GAAP financials, specifically because of FAS 143 and FAS 133. He noted that management and banks use operating statements. He stated that if banks did not require GAAP financials, they would be a very large private company that does not produce GAAP financial statements.

8. Mr. Mechanick asked Mr. Delametter to specifically address the use of GAAP financials by ESOP participants. Mr. Delametter noted that the primary user of the ESOP is a trustee, who also receives operating statements and asks some questions. He noted that 20 years ago, GAAP financials were the primary source of financial information and, unfortunately that is no longer the case.

9. Mr. Linsmeier noted that financial statements for public companies are also a single data point, with other data points including analysts' reports, preliminary earnings releases, and earnings calls. Accordingly, he stressed the need to dig deeper to differentiate private company uses from public companies. He stated that a potential starting point could be to view GAAP financials as a base set of financial information used to confirm decisions made on a relationship management approach, and to prepare quality questions to use going forward. He also noted that GAAP financials should make these communications and decisions more cost-effective, and questioned if and how this requires the needs of private companies to be different from public companies. Mr. Linsmeier also noted the increasingly complex nature of today's business environment and that this complexity may not directly affect daily cash flows, but it does have an overall wealth affect. He noted that perhaps the FASB could do a better job communicating these operating vs. wealth effects.

10. Mr. Townsdin mentioned the range of accounting-related sophistication amongst his private company clients, and noted that while some clients and their audit committees could be compared to many public companies, others do not have that level of sophistication and depend on their auditors for the implementation and application of new standards.

11. Mr. Buck responded to Mr. Delametter's comment regarding ESOPs, and noted that his company is 100% ESOP owned. He also mentioned that the ESOP trustee is technically the only shareholder in the plan, while each participant is considered a beneficial owner of the stock. Therefore, the ESOP participants are only provided with annual summary

reports, instead of full GAAP financial statements. He also stated that he agreed with Mr. Linsmeier on the notion of GAAP financial statements serving as a starting point on which to base questions, but stated that this objective could be achieved through disclosures. He noted the example of a related-party leasing entity, and how the disclosure of this arrangement would allow a user to ask appropriate questions, but requiring the preparer to recognize and measure the assets of that leasing entity may not be appropriate.

12. Mr. Mechanick raised a follow-up question regarding the importance of the income statement as opposed to the balance sheet. Mr. Buck responded by mentioning that equity investors of public companies are primarily concerned with the value they could receive if they decided to sell at a specific point in time, while private company investors are primarily concerned with access to debt capital. For lenders, he stated, monitoring economic performance is more important than the total wealth effects. He mentioned that he observed a shift in the FASB’s focus toward the balance sheet, while private companies remain focused on the income statement. Mr. Buck also noted that both of his primary users, banks and the ESOP trustee, are primarily concerned with various measures of performance or proxies for earnings. In summary, he stated that operational performance is what matters most.

13. Mr. Mendelson responded to some of Mr. Linsmeier’s remarks, noting that from his perspective as an attorney, GAAP financials are used differently amongst private and public companies. He mentioned that public companies try to minimize and script their disclosures, and this is especially evident in smaller companies that eventually become public. He noted that for public companies, GAAP financial statements are held in the highest esteem, and analyst reports are based off them. Furthermore, he noted that even during calls with the public companies, the information received is limited compared to calls with private companies.

14. Mr. Mendelson also noted that he agrees that GAAP financials should be used as a base for further analysis, but the issue is defining what should be reported in the base. As an example of what he believes to be an inappropriate inclusion, he cited how agreements between his fund and the investees historically included predetermined valuation metrics for the investment; however, FAS 157 currently does not allow this to occur. Now, he

must succumb to the requirements of FAS 157 in order to produce information that is not agreeable amongst different parties at an extremely high cost.

15. Mr. Stolte mentioned that while he agrees that most of his clients are concerned with the operational performance of an entity, he also believes the wealth effects are important to users. He noted, however, that many of the potential wealth effects, such as potential liabilities, are covered by existing standards and do not need to be specifically addressed by their own standards. He specifically mentioned how the FAS 5 guidance covers many potential risks of loss, and should be followed more closely by users.

16. Mr. Christenson noted that his company is a member-owned organization, similar to a mutual insurance company where policy-holders are the owners of the organization. He stated that he has two sets of users, his member-users and his parent-company to whom his company issues private placement debt. He pointed to a physical copy of the financial statements that he issues to his member-owners, which includes summary metrics and graphs, and noted how that report is drastically different from the GAAP statements. He also noted that his company is much more concerned with the balance sheet because the member-owners are concerned with the overall financial strength of the company, as opposed to the operating performance.

17. Ms. Rockhold mentioned that it is important to keep in mind that GAAP financial statements also provide benefits to users by requiring the rigors and process of an audit. She noted, however, that because of some of the complexities involved in GAAP disclosure requirements, many early-stage companies skip the audit, which is a disadvantage to users who are interested in the other benefits of an audit, such as looking at internal controls. She stated that she would like to find a way to have both quality financial statements as well as an audit. Mr. Mechanick stated that this sentiment was also expressed by members of the Blue Ribbon Panel. Ms. Rockhold also commented on Mr. Mendelson’s remarks regarding fair value. She noted that the general partners are actively involved in the management of their investments, and because of their extremely close relationship, they are in the best position to provide a fair value of their investment. She noted that they also play a significant role in the next stage of financing, which serves as the most recent measure of value. Finally, she noted that the fees paid to certain

fund managers are, in effect, a vote to trust their discretion regarding certain decisions, including how to value the investments.

18. Mr. Smith noted that he would like to figure out how to incorporate what he is hearing into the standard-setting process. He acknowledged Mr. Mendelson’s remarks regarding a single base set of financial statements applicable to private and public companies, and understands his concerns that standards have grown too complex and onerous. He asked where to go from here, and whether there should be a project to determine what the base standards should be. He asked if the participants, and the private company constituents at large, could help create the “base,” and subsequently help incorporate the differential needs of private vs. public companies, or small vs. large companies.

19. Mr. Jones acknowledged the difficult task the FASB has, and how society expects the FASB to detect and prevent major accounting scandals. He responded to Mr. Smith’s previous statement with the suggestion to keep things simple. He stated that Silicon Valley Bank lends to borrowers and expects to be paid back in cash, not other assets or receivables. Therefore, he said that he monitors the borrower’s ability to repay in cash and noted that many other investors do the same, including his shareholders who attempt to model the ability for SVB to generate cash and reinvest or distribute that cash to its shareholders. Mr. Jones also noted his desire to have a simplified financial statement that will help him understand the flow of cash and not be overburdened by extraneous and distracting information. Mr. Jones also mentioned that he understands why it is a necessity that the Board consider and manage preparer deceit.

20. Mr. Schramm noted the incredible diversity associated with private company investors and how GAAP financials attempt to create broad standards that encompass the needs of this very divergent group. He stated that once the level of focus is on the individual user, the user needs become much more specialized and suddenly there is a natural tension between the broad financial statements offered by GAAP and the specific needs of individual users. He suggested the possibility of offering specialized financial statements to investors to whom GAAP financial statements are of little use.

21. Mr. Catalano asked participants how they incorporate the footnotes into their analysis of a company. Mr. Mendelson respond that he does not use the footnotes at all because they are only there because they are required and add little value for early-stage enterprises.

He also noted that ten years ago, 80% of the companies his firm analyzed for initial investments had GAAP financials, and now that number is roughly 5-10% because they are too expensive. Mr. Mechanick noted that that view is that of a venture capitalist, while a private equity firm would analyze more mature companies and would probably use the footnotes as red-flags. Mr. Mendelson responded by describing his use of a "schedule of exceptions," which is essentially a list of information regarding the investee for which the investee will verify its truth. He noted that this essentially fills the void of GAAP disclosures.

22. Mr. Smith responded by noting that Mr. Mendelson's remarks are contradictory to the suggestions of other participants to include more information in the footnotes rather than the financial statements. Mr. Mendelson clarified his prior statement by stating that he is not reading the footnotes because there are no footnotes for most of his investees, and he would read them if there were footnotes. He noted that the reason companies do not report footnotes are because some of the early stage companies cannot afford to do so, and this could create bad habits for these companies regarding their accounting and reporting practices.

23. Mr. Jones noted that he uses the footnotes to develop better questions for management, and cited the use of contingency disclosures to gain an understanding of obligations that are not on the balance sheet and that could affect the company's ability to repay debt. He mentioned the need for disclosures that actually add value and that are relevant, as opposed to disclosures such as the definition of "cash and cash equivalents."

24. Mr. Bodine agreed that one of the major differences amongst private-company users is the access they have to management, and noted that because of this access, a "red flag" approach is effective. This approach, he stated, would involve informing the user that certain contingencies exist, and allowing the user to elaborate on the effects of that contingency by leveraging the access to management. He stated that the biggest difference among private company users is the cost effect, internal resources, and the cost of external resources. He noted the FASB's previous quantitative approach toward standard setting, citing complex quantitative methods to account for derivatives and VIEs. He contrasted that with the current trend towards a more qualitative approach and noted that this process is easier to perform, specifically citing FAS 167 and the new

derivatives approach outlined in the Exposure Draft for Financial Instruments as examples of this improvement.

25. Mr. Linsmeier recapped what he heard from the participants, and noted that even amongst the roundtable participants, there was significant variation in the views regarding fair value, disclosures, balance sheet vs. income statements, and presentation and uses of financial statements. He mentioned how it is difficult to reach the "sweet spot" to meet the varying demands. He noted that private companies may be less complex with more specific users, and this could result in increased costs because a company's specific user may be far from the base requirements for financial statements. He also inferred that based on the discussion, participants view the income statement as being of poor quality, particularly regarding the separation of operating performance from other wealth effects. He also heard that disclosures were becoming too complex. He noted that public companies are more concerned with compliance and satisfying the minimum reporting requirements while private companies are more concerned with effective communication to their stakeholders, and standard setting can benefit from this theme of better communication.

26. Mr. Christenson mentioned the need for flexibility in private company financial reporting, and the ability to tailor financial statements to the needs of the users. He noted the prescriptive nature of the footnotes and how they often contain extraneous information, suggesting that the prescriptive content should be reserved for regulatory documents rather than the financials.

27. Mr. Stolte noted that the perception amongst smaller companies is that the standards are forced down upon them, and he appreciates the Board taking the time to solicit feedback. He stated that the goal should be simplicity, and that a lot of current requirements do not make sense, citing the example of the requirement to disclose the definition of cash and cash equivalents while not being required to disclose a company's revenue recognition policy. He stated that it seems like standards are set for public companies and then adjusted to accommodate private companies when, instead, they should start out at base level applicable to all companies and have increased requirements for public companies. He also agreed with Ms. Rockhold's observation that more companies avoid audits because of the increasing complexities and costs involved.

28. Mr. Buck noted his appreciation for the scope section of IFRS for Small and Medium sized Entities, which distinguishes between companies that have "public accountability," and mentioned that these companies could include large privately owned banks and insurance companies, and have a different level of applicability. He stated that complexity does not differentiate between private and public companies. He also stated that public companies have chosen to subject themselves to the insatiable appetite of information that equity analysts have as a cost to access the capital markets, and that private companies should not be subjected to the costs of satisfying the analysts' demands. Mr. Buck also noted that the majority of the costs in financial reporting are in recognition and measurement, not disclosures.

29. Ms. Rockhold stated that information in the footnotes should not be a surprise to users of private company financial statements, and stated that the financial statements and the disclosures should be core financial information, as opposed to estimates and forecasts that currently make up the disclosures. She stated her support for different private vs. public company standards, noting that allowing more judgment in financial reporting is a positive step and private companies could always choose to report using the higher standards of public companies if they wish.

30. Mr. Townsdin noted that the key to this discussion is defining the basic accounting standards, and that they should apply to everyone. He noted that a base level of financial accounting standards would allow more companies to go through the rigors of an audit using the base standards, and augment those standards with more specific details regarding the risks and exposures of the business. He also mentioned that once a base set of standards is defined, they should not be tampered with.

31. Ms. O'Dell posed a question gauging the SEC's role in adding public-company issues to the Board's agenda. She also observed that the sentiment amongst the participants in the Blue Ribbon Panel meetings is that the "Model 3" approach, which is financial reporting model that begins with a base level of standards and adds more rigorous requirements for SEC registrants, makes a good deal of conceptual sense, though it could take some time to put into place.

32. Mr. Smith mentioned that he heard a demand for a principle for disclosures, rather than a list of disclosure requirements, and noted the disclosure framework project that is aimed

at creating a framework that will guide the Board in writing disclosure requirements that meet a common set of objectives. He mentioned the project team is starting with a baseline of principles for the disclosures, which include relevance and their existence being essential to the understanding of financial statements, but how this appears to be blatantly obvious. He noted the difficulty in crafting a principle that is useful and not so broad that it is meaningless, and welcomed any comments. Mr. Mechanick noted that many of the meeting participants seemed as if they would support a "red flag" approach for private companies, in which disclosures should provide enough information for users to understand if there is an issue and to leverage their access to management to follow up on the issue.

33. Mr. Delametter mentioned that he believes the Blue Ribbon Panel's recommendation of a separate board for private companies is on the right path. Mr. Mechanick clarified that there are still many operational details to be worked out in the upcoming December meeting. Mr. Delametter also noted his concern of the SEC's involvement in the creation of standards, and cited their reported influence on the leases project and how their reaction to implementation concerns was that complex transactions require complex accounting. He stated that he does not understand how to implement these complex standards in large companies so that the cost is not prohibitive and favors a more simple approach to accounting, such as the "build up" approach, where there would be a base set of standards for all companies to apply with more stringent requirements for SEC registrants. Mr. Stolte noted his appreciation for certain disclosure bright lines, stating that they help him settle disputes with his clients regarding what is appropriate to disclose.

34. Mr. Smith mentioned that the extent of the SEC's involvement in the standard setting process has primarily been in adding items to the board's agenda. He noted their influence in adding FIN 46(R) to the agenda, which was a reaction to the Enron scandal. The SEC influenced the addition of FIN 48, which was a reaction to significant diversity in practice with regard to reporting of uncertain tax provisions. The SEC also influenced the current lease project's addition to the agenda as a result of off-balance sheet accounting studies, and how most leases were not recorded on the balance sheet. He

noted that the SEC did not have influence, at least in his 8 years at the FASB, in any of the decisions reached regarding each project.

ISSUE 2: PRIVATE COMPANY CONCERNS REGARDING FIN 48 AND FIN 46(R)/ FAS 167

35. Mr. Smith stated that there was a public company view when writing FIN 48, and noted how the decision was to ignore detection risk when accounting for uncertain tax positions. He understood the frustration this causes for many private companies who are required to record liabilities related to uncertain tax positions that may never be incurred. He mentioned that education was part of the problem relating to FIN 48, and also the question of what to do for flow-through entities and how the company should at least assess the validity of the company’s legal status. He noted that state nexus issues and whether a company is taxable in certain states were areas of difficulty. Mr. Christenson noted that while detection risk is not a major issue for his company, state nexus issues certainly are a major issue but he does not know if that is unique to private companies.

36. Mr. Buck mentioned that the clarification on pass-through entities was extremely helpful and gave credit to the Board and Paul Glotzer for pushing that through. He noted that he does not believe FIN 48 disclosures are relevant for private companies and that many users would have access to the tax returns as well, and questions could be asked for any items requiring additional clarification. He stated that an unfortunate burden placed on private companies as a result of FIN 48 is the IRS using these disclosures as a roadmap, even though they say they do not.

37. Mark Wells mentioned the issue of the timing of the issuance of standards, and that many private company users do not keep abreast on the most recent standard-setting developments. He also stated that education does not occur until the summer. Therefore, he noted that when standards are issued late in the year with the effective date being December 31, this creates the potential for CPAs to miss the requirements. Mr. Mechanick noted that the Board is aware of this issue and is responding to it through one-year effective-date deferrals that are now common for non-public entities. . Mr. Schramm mentioned that the delayed effective dates allowed him to learn from many of his public

clients, which made implementation more efficient for private companies. Mr. Townsdin stated that he is able to gain a perspective about how aggressive a client's tax positions are by speaking with them, and that it may be difficult to gain this perspective through disclosures. Mr. Bodine mentioned that the IRS's potential use of FIN 48 disclosures as a roadmap creates a disincentive for an audit. He suggested that a solution should be factoring detection risks into the uncertain tax provision analysis. Mr. Christenson added that this solution does not have to be unique to private companies. Mr. Schramm cautioned that there may be unintended consequences if there was a revision to include detection risks, and mentioned how this would analogize to environmental risks and other contingencies.

38. Mr. Mechanick asked Ms. O'Dell to share an example of a common ownership structure to illustrate the impact of FIN 46(R). Ms. O'Dell described a typical private-company fact pattern that causes much concern throughout the private company constituency:

- Joe has a manufacturing company and he needs a new building.
- The manufacturing company is a C Corporation; therefore, if there is a gain on a building owned by the C Corp, it is taxed twice.
- To avoid this, Joe forms a separate partnership that he owns to hold the building and lease it to the manufacturing company.
- There may or may not be the same bank lending to both entities. Sometimes the bank holds a mortgage on the real estate and provides an equipment loan or line of credit.
- The building is only used for manufacturing, and will be used as long as the company is in business.
- There may be cross-guarantees.
- The lease is not capitalized under current GAAP.
- Sometimes the bank requires a formal lease. Sometimes there is no stated rent, and whatever is left over from the C Corp is paid out as rent for tax purposes.

39. She noted that a result of this fact pattern and the consolidation conclusions reached, is that many preparers take GAAP exceptions on their audit opinions, which could lead to a slippery slope: if companies are taking many GAAP exceptions, then the comparability of GAAP financial statements is compromised. She also noted that she does not believe

this fact pattern was clearly articulated and considered by the Boards during their deliberations of FIN 46(R).

40. Mr. Stolte noted that many of his clients have users who do not care about the leasing company, and there have been times when he issues audit opinions with GAAP exceptions for this issue. He also stated that he does not think GAAP exceptions are a sustainable solution, and that it is a slippery slope. He stated that he does not believe consolidation is necessary unless there is some sort of guarantee which would represent a real risk of loss, and even those guarantees would be disclosed under FIN 45.

41. Mr. Jones mentioned that, as a banker, he looks at the financial statements as a source of repayment and would like to know about guarantees and contingencies but particularly wants to analyze the source of repayment. He stated that clouding the financial statements with assets that a lender does not have access to is not useful.

42. Mr. Linsmeier noted that there is not unanimity amongst private company constituents regarding what the consolidations conclusion should be in this situation, and cited the view of sureties and how they appreciate consolidated statements. He acknowledged that the problem of potentially distorting the assets that a claimant has access to is a problem inherent in consolidated financial statements, and that a possible solution could be consolidating financials. Regardless of the solution, Mr. Linsmeier mentioned that he learned from dealing with this issue that there is a need for a mechanism to understand these issues sooner. He also stated that private companies may only have a few claimants, while public companies could have many. Therefore, while it may be cost beneficial to satisfy the demands of numerous users associated with public companies by requiring consolidated statements, this may not be the case with private companies who have a limited number of claimants.

43. Mr. Smith discussed this situation at a more detailed level, and offered two examples. The first example is a manufacturing entity that purchases a specialized manufacturing facility using non-recourse debt, with the expected cash flows from the sales of widgets used to pay off the debt. He stated that he believes the manufacturing company should record the facility on its balance sheet. He noted another example where a manufacturing entity sets up a separate legal entity to purchase the specialized facility using non-recourse debt, and structures a lease to avoid capitalizing the facility on the

manufacturing entity's books. He noted that the two transactions are effectively the same and should result in similar accounting treatments.

44. Mr. Jones clarified the second situation such that the owner of the manufacturing entity is also a significant owner of the lessor entity. He stated that disclosures informing him that there is a related party leasing transaction are sufficient and that he would be adverse to consolidating the assets and liabilities of the lessor entity because it would skew his analysis of what other liabilities the entity is obligated to and what assets he is entitled to in the event of default. Mr. Linsmeier asked if he would have enough information to know if the leasing agreement would not provide enough cash flows to cover the debt, or if this could only be portrayed through consolidated statements. Mr. Jones responded that he would find that out through discussions with management and that the disclosures would provide a reasonable basis to develop questions for that discussion.

45. Mr. Mendelson stated that he experienced the negative repercussions of the lack of related-party disclosures and, as a result, built clauses into his contracts that require the detailed disclosure of related party transactions. He stated that he then uses the information obtained through that clause to conduct further research. Mr. Townsdin noted that perhaps if there is a guarantee, consolidate, if not, do not consolidate. He stated that perhaps there is no right answer, and information should be presented so that the users can develop questions for management.

ISSUE 3: PRIVATE COMPANY CONCERNS REGARDING FAIR VALUE MEASUREMENT AND DISCLOSURE

46. Mr. Mechanick introduced the topic of fair value measurements and disclosures and noted that Ms. O'Dell previously stated that this would be a potentially divergent issue with private companies moving forward. He also mentioned that IFRS for Small and Medium-Sized Entities provided simplified guidance somewhat limiting the extent of fair value measurements and disclosures and so did Canadian GAAP for Private Enterprises. He indicated that the most problematic aspects of FAS 157 noted during the October 12 roundtable in Norwalk included measurement of level 3 assets, especially non-financial

assets. He also stated that there was discussion regarding goodwill impairment and the fair value approach involved in that process.

47. Mr. Mendelson described the implementation of FAS 157 from the perspective of a venture capital firm. He stated that the issue of fair value differs depending on the type of entity in which you are investing. He stated that historically, he would agree on a valuation methodology with both the investee and the limited partners and would record the investment on the books using that methodology. If the company was doing poorly, he would write down the investment, but he would not write it up unless there was another round of third party financing. He stated that upon initial implementation of FAS 157, the auditors did not understand how to apply this to his business model, and he was told to mark up the investment if the value increased, which is difficult to apply practically. He was forced to use public comparables and run his investments through typical DCF and option-pricing models. He described a situation where there were various models of the same investees that would not reconcile and that the fair value requirements resulted in significant inefficiencies for useless information.

48. Ms. Rockhold noted that the valuation of venture capital investments is a significant issue and that when expanded over hundreds of firms with different valuation methodologies, this can become extremely inefficient. She asked if we should value valuation agreements between two parties. Ms. Kapka noted that she teaches audit and that there could be many different valuation methodologies when auditing fair value. Ms. Rockhold noted that although there are many different methodologies, there are still ways to become comfortable with management's process to determine the fair market values. Mr. Christenson questioned whether this is a FASB issue or an auditor issue. Mr. Smith disagreed with Mr. Christenson's statement and noted that this is a FASB issue. While FAS 157 provides guidance on how to measure something, the other issue is what the appropriate measurement basis is for private equity companies, which the Board will address as part of the project on Accounting for Financial Instruments. Mr. Linsmeier noted that this is a system issue and the FASB is part of the system. He acknowledged the issue of determining what model is the most appropriate when determining the fair value using level 3 inputs. He questioned whether fair value is the appropriate measurement attribute for private equity companies and, if it is, whether to allow practical expedients

similar to the net-asset-value practical expedient for investments in investment companies.

49. Mr. Townsdin believes this is a FASB issue and provided an example where two sophisticated parties cannot agree on a common value and there is a day 1 gain on an acquisition. He stated that there is a tremendous amount of judgment involved in these valuations and it is difficult to audit, and that this may not be appropriate from a private-company perspective. He also stated that a day 1 gain is difficult to explain to people. Mr. Linsmeier noted that the issue is not only the period in which the transaction occurred, but also in future periods where there is no transaction and one is still required to estimate the value. He stated that he would interpret an exchange price in an inactive market as level 2, and does not understand the move to level 3 in this particular example. Mr. Mendelson noted the impracticability involved in valuing a company with no product or customers, and stated that he would like to go back to a world in which he can contract on the appropriate valuation methodologies so he can focus on his actual business rather than the accounting.

50. Mr. Buck stated that he believes financial statements should focus on information that is most relevant to the user, and users of private company financials value reliability and verifiability over more subjective measures such as level 3 fair value. He stated that a typical user wants to know the cash flows of an entity and that numbers on the balance sheet should include values that are easily determinable, audited, and verified. Users are typically looking for a stamp of approval to verify the financial information they are receiving and would prefer amortized cost or some contractually agreed-upon valuation methodologies, as opposed to judgment. Mr. Schramm noted that if it is possible to come up with a more cost-effective means to report while remaining true to the underlying economics, public companies would like those standards to apply for them as well.

ISSUE 4: GOODWILL

51. Mr. Townsdin stated that there are situations where a company has been profitable for years, but a reporting entity still has to hire a valuation specialist at a significant cost to verify that there is no step-one goodwill impairment. He stated a reasonable person would

be able to see there is no impairment and, in his opinion, a company should get rid of goodwill at day 1 because the economics have already occurred. Mr. Bodine noted that many clients have suggested support for an option of an immediate write-off or a systematic write-off, but he would support an immediate write-off of goodwill.

52. Mr. Buck stated his support for an immediate write-off of goodwill and noted that many users do not care about goodwill being recorded on the balance sheet and that a systematic write-off is not justifiable. He mentioned that an alternative to the current annual impairment model could be an impairment model based off certain trigger events. Mr. Stolte noted that recording goodwill and keeping it on the books gives users information on management's ability to make wise investment and acquisition decisions, but also mentioned that many private company users do not include goodwill in their analysis.

CONCLUDING REMARKS

53. Mr. Smith expressed his hopes to better incorporate the unique needs and demands of the non-public constituency in the standard-setting process, and to more carefully consider certain cost constraints. He viewed the overall theme of the discussion to be simplicity, and mentioned that although business has become much more complex, the FASB needs to come up with ways to simplify the standards. Mr. Linsmeier noted that he believed the two private company roundtables were a productive beginning to an ongoing dialogue to better include the views of private company constituents within the standard-setting process.

Attachment A

FASB Roundtable Meeting Agenda

Private Company Concerns regarding Consolidations

1. There is a presumption in U.S. GAAP that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for fair presentation (810-10-10-1). The FASB's recently issued Statement 167, Amendments to Interpretation No. 46(R) now requires that the consolidation analysis for variable interest entities be based on a notion of control. Although there is a difference in the definition of control, this requirement is similar to the consolidation requirements for voting interest entities. Do you agree that the consolidation requirements should be based on the notion of control? If not, please articulate your rationale for not consolidating when a reporting entity controls another entity.

2. A common structure amongst private companies involves an operating entity leasing assets from a commonly owned lessor. Often, the operating entity is required to consolidate the commonly owned lessor entity as a result of the lessor entity being considered a variable interest entity and the operating entity being identified as the entity within the controlling related party group that is most closely related to the variable interest entity. Do you believe consolidating financial statements, or the recent requirements under Statement No. 167 to require separate presentation of elements of consolidated VIEs (ASC 810-10-45-25), alleviates these concerns?

3. The related-party guidance in paragraphs 810-10-25-42 through 25-44 (as amended by Statement 167) limits structuring opportunities by requiring a reporting entity to consider certain rights and/or interests held by its related-parties in the consolidation analysis. As discussed in question 2, the FASB is aware of certain private company scenarios where the related-party guidance may cause an operating entity to consolidate another commonly controlled entity. Please articulate any suggestions to improve the related party guidance that will alleviate private company concerns while preserving the objectives of the related party guidance.

4. The variable interest subsection in Subtopic 810-10 includes implementation guidance and illustrations in an attempt to provide examples on how to apply the concepts in paragraph 810-10-25-38A for identifying whether to consolidate a VIE to various fact patterns. Do the illustrations provide useful guidance for private companies applying the variable interest subsection in Subtopic 810-10 (as amended by Statement 167)? If not, please provide a detailed description of typical scenarios requiring significant judgment when applying the requirements in paragraph 810-10-25-38A that are not addressed in the implementation guidance.

5. The requirement to consider implicit variable interests is often considered to add complexities in the consolidations analysis performed for variable interest entities. The Board included this requirement to incorporate entities lacking explicitly stated interests that may hold otherwise substantive implicit variable interests within the consolidations analysis. The FASB is aware that there are significant concerns as to how private entities should apply the implicit variable interest guidance in the context of private companies? Please provide suggestions for improvements to this area, including how you believe that this will result in a more sound conclusion of which entity controls a variable interest entity.

Private Company Concerns regarding Uncertain Tax Provisions

1. Describe the impact (material, immaterial or none) that the adoption of FIN 48 (Topic 740) had on the financial statements that you were involved with.

2. Describe the challenges associated with implementing FIN 48.

3. Share your views on the applicability of FIN 48 to non-public entities, and what improvements or further implementation guidance you feel should be considered in order to improve upon the requirements.

Attachment B

Roundtable Participants

Name	**Affiliation**
Steve Bodine	LarsonAllen - Firm
Renee’ Duncan	Binkley & Barfield, Inc - Firm
Bill Schramm	PricewaterhouseCoopers - Firm
John Stolte	MarksNelson - Firm
Doug Townsdin	Grant Thornton LLP - Firm
Dave Jones	Silicon Valley Bank Capital - User
Anne Rockhold	Silicon Valley Bank Capital - User
Jason Mendelson	Foundry Group - User
Mark Wells	Thomson Reuters/PPC - Educator
Kathryn Kapka	University of Texas - Academic
Daryl E. Buck	Reasor’s Holding Company, Inc. - Preparer
Dave Christenson	United Services Automobile Association - Preparer
Marc Delametter	QuikTrip Corporation - Preparer
Judy O’Dell	PCFRC