

Private Company Financial Reporting Committee

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JUDITH H. O'DELL
Chair

July 18, 2008

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*

Dear Mr. Herz:

As stated in our May 23, 2008 letter to you, Private Company Financial Reporting Committee ("PCFRC") constituents have consistently expressed a number of concerns about FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* ("FIN 46(R)" or "Interpretation"), and have asked that the PCFRC speak further to that Interpretation. Our May 23, 2008 letter highlighted areas of particular concern to private companies in dealing with FIN 46(R). The PCFRC has continued to discuss FIN 46(R) at its meetings. Additionally, we have conducted outreach to private company financial reporting users, preparers, and practitioners seeking information about the costs and benefits of FIN 46(R), and information about any implementation issues that constituents are experiencing.

The PCFRC's work in this area reveals:

1. GAAP-exception reports have significantly increased due to noncompliance with FIN 46(R). Often, private company financial reporting users are interested in and request stand-alone parent-only financial statements. Despite the fact that these financial statements do not comply with GAAP, these users find the financial statements useful inasmuch as they often base their decision making on parent-only financial statements.

Ideally, the use of GAAP exceptions should be kept at a minimum. The increasing frequency of GAAP exceptions, attributable to FIN 46(R), diminishes the value and meaningfulness of GAAP.

2. Private company financial reporting users' needs appear to be diverse depending upon the nature of the user (e.g., lender, surety, venture capitalist) and their purposes. This diversity in users' needs reinforces the necessity of the stand-alone parent-only financial statements option in the private company domain. Accounting standards should be flexible to accommodate diverse financial statement users' needs.
3. FIN 46(R) compliance costs are burdensome for private company financial statement preparers and practitioners. Moreover, the benefits related to the expenditure of these costs are questionable. Significant compliance costs are often attributable to identifying variable interests (especially implicit variable interests), assessing and quantifying those variable interests, the complexity related to understanding the Interpretation, performing the consolidation work, and additional audit, review, and compilation fees.
4. Inconsistent interpretation and implementation of FIN 46(R) is common among private companies, causing diversity in practice. The subjectivity of certain requirements of FIN 46(R) and the complexity of the Interpretation may be driving its inconsistent interpretation and implementation in the private company arena.

Recommendation: The PCFRC voted (12-1) to issue the following recommendation to the FASB.

The PCFRC recommends that the FASB allow stand-alone parent-only financial statements under GAAP for private companies. Such parent-only financial statements would continue to contain adequate disclosures about related-party entities and activities. Although the PCFRC understands the FASB's and the International Accounting Standards Board's position on parent-only financial statements, as put forth in the May 29, 2008 Preliminary Views, *Conceptual Framework for Financial Reporting: The Reporting Entity*, the PCFRC believes that allowing stand-alone parent-only financial statements is warranted in the private company sphere. If a private company preparer and user agree that parent-only financial statements satisfy their financial reporting needs, this option will free private company preparers and practitioners from the costly burden of FIN 46(R), without depriving the financial statement user of any benefits. Furthermore, this option will reduce GAAP-exception reports, and reduce diversity in practice. Granting private company financial reporting constituents the option to decide between consolidated or stand-alone parent-

only financial statements, based on their needs, is a market-driven solution that increases the relevance of GAAP for these constituencies.

Dissenting Opinion (one PCFRC member dissented from the above recommendation)

Full disclosure in a bond principal's financial statements is paramount to a surety's ability to underwrite effectively. A private company exception to FIN 46(R) is contrary to this interest. Private companies should not be exempted from the basic principles of consolidation as enunciated in Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, as such principles pertain to entities in which a controlling interest is defined by other than voting interest. To save accounting costs, bond principals will choose to prepare parent-only financial statements if the above recommendation is accepted. This decision likely will be made with no input from the surety, because experience shows that a surety is not consulted regarding the extent and nature of disclosures. Reduced disclosure will become the norm, creating adverse effects for sureties, which would outweigh any cost savings.

The PCFRC appreciates the FASB's consideration of the recommendation in this letter. Please feel free to contact me if you have any questions or comments

Sincerely,



Judith H. O'Dell
Chair
Private Company Financial Reporting Committee