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JUDITH H. O'DELL
Chair

April 14, 2009

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

Re: Financial Statement Presentation Discussion Paper

Dear Mr. Herz:

In developing our comment letter on the Financial Statement Presentation Discussion Paper ("Discussion Paper", or "proposed model"), the Private Company Financial Reporting Committee ("PCFRC") conducted extensive committee discussions, engaged in outreach to our Resource Group, and held discussions with representatives from some key user organizations. Presented below are the results of those efforts.

Summary of Major Points

The PCFRC's work indicates that the proposed model presents improvements and detriments to private company financial reporting, depending upon the perspective of the private company constituent. The objectives of the proposed model make conceptual sense for private companies; however, a number of private company constituents believe the approach the FASB has taken to achieve those objectives goes too far and will not prove beneficial. Private company financial reporting constituent groups disagree on certain aspects of the proposed model. Their viewpoints, based on the PCFRC's discussions and on the input received, have been presented and grouped into the following categories within this letter:

1. Objectives and principles of financial statement presentation
2. The application of the proposed model to nonpublic entities
3. Separation of activities, assets, and liabilities in the financial statements
4. Disaggregation of financial information
5. The management approach
6. Direct method of reporting cash flows
7. Reconciliation schedule
8. Cash Equivalents
9. Other

Objectives and Principles of Financial Statement Presentation

(Respondent Question No.1)

Financial statements that are more cohesive, contain disaggregated information, and make a company's liquidity and financial flexibility more transparent would facilitate the analysis of financial reporting and the decision making by private company financial statement users. As such, the objectives of the proposed financial statement model are important to private company constituents and make conceptual sense. However, the PCFRC questions whether the proposed model goes too far in trying to achieve these objectives at the line-item level. The objectives may be achievable at a much less disaggregated level.

Application of the Proposed Model to Nonpublic Entities

(Respondent Question No. 27)

Presented below are viewpoints and suggestions about the application of the proposed model to private companies, based on the PCFRC's discussions and on the input to date that the PCFRC has received. The FASB may want to consider conducting additional research in the private company sector about the advantages and disadvantages of the proposed model, including its costs and benefits to users, preparers, and practitioners. The PCFRC stands ready to assist the FASB in that research through various means, including the formation of user focus groups to meet with FASB members and staff.

Private company lender-user viewpoint based on PCFRC discussions and available input.

Current model is adequate/Proposed model offers negligible benefit besides direct method cash flows. Lender-users, who represent the majority of private company users, believe the proposed model offers them mostly costs and little benefit, other than the direct method of reporting cash flows. These users think the proposed model is more applicable to public companies than to private companies. The typical private company is a small, simplistic business engaged in a single economic activity with relatively few accounting line items. Therefore the proposed model provides little benefit to lenders who conduct business with those entities, especially in light of the costs of implementing the proposed model.

Most of the time, when lenders lose money related to private company borrowers it is not because of an inability to analyze the financial statements or because those financial statements lack transparency. It is mainly because management is poor, or the business they are in has a core flaw, or sales decline and management cannot cut costs fast enough. Given that dynamic, the current financial statement model has admirably fulfilled lenders' analytical needs related to private company financial reporting for many years.

Given the sufficiency of the current financial statement model, the proposed model does not appear to provide much benefit to private company lenders and in fact aspects of the proposed model appear to be detrimental to their decision making. The requirement to report cash flows using the direct method is the one significant aspect of the proposed model that lender-users value. Other than that, no significant new information or capabilities that benefit a lender's decision making appears to be generated by the proposed model. The underlying relationships in the financial statements and core analytics remain unchanged. Lenders who extend credit to private companies generally focus on analyzing a borrower's compliance with loan agreements, cash conversion cycles, working capital, and liquidity. The proposed model to create connectivity between the financial statements does not aid that analysis or improve credit decision making capabilities for lenders. For example, if a borrower's obligation is coming due, it does not matter to the lender if the obligation is classified in an operating section or a financing section of the statement of financial position

Lender-users are of the opinion that the objectives of the proposed financial statement model can be achieved for private companies by requiring the direct method cash flow statement, which will link the statement of financial position and statement of comprehensive income, and by requiring additional disaggregated information to be presented in the notes to the financial statements. Revamping the structure and format of the financial statements and requiring substantially more disaggregated information on the face of the statements appears excessive and unnecessary.

Costs to comply with the Proposed Model. Lenders will incur major costs if the proposed model is finalized. Among those costs are:

- Revamping their systems (including remapping for quantitative modeling)
- Training staff in accounting and credit risk/financial statement analysis.
- Re-engineering small business credit scoring models.
- Replacing risk rating models and validation of those new models.
- Overhauling industry text books and training materials.
- Rewriting and renegotiating loan covenants
- Re-programming databases to accommodate new financial statement presentation.
- Reconverting financial statements under the new model back to the current model, to aid analysis.

In the lender's viewpoint, the benefits of the proposed model do not justify these steep costs.

Industry databases. Lenders utilize industry statistics in their comparative analyses (for example, the Risk Management Association's financial statement database product.) Changing the format of financial statements will decrease the value of those databases and necessitate costly changes.

GAAP exceptions. Lenders are seeing more and more private company borrowers presenting financial statements with GAAP exceptions, due to the increasing costs of complying with GAAP. The proposed model will likely strengthen that trend, as certain private companies will resist complying with the new model due to conversion costs and a lack of perceived benefit. The increasing frequency of GAAP exceptions diminishes the value and meaningfulness of GAAP.

Private company venture capitalist-user viewpoint based on PCFRC discussions and available input.

Aspects of the proposed model are useful improvements. The PCFRC's discussion with venture capital representatives centered around two aspects — private companies that they have an ownership interest in and private companies that they are looking to gain an interest in. These venture capital representatives find some portions of the proposed model to be useful improvements. Primarily these users find the proposed additional disaggregated information in the income statement and the breaking out of discontinued operations to be positive developments.

Too much disaggregated detail a concern. Of concern to the venture capitalist-users was the level of disaggregated detail proposed in the Discussion Paper. While a certain degree of additional information is welcome, especially in the income statement, too much detail can become overwhelming to a financial statement reader and obscure the key elements of the financial report. Furthermore, requiring significantly more information in the financial statements could introduce a higher level of management judgment and reduce comparability across companies. Venture capitalist-users often sit on the boards of private companies and consequently have access to financial information beyond what is currently displayed in the financial statements. As such, requiring substantially more detailed information in all the financial statements would not provide a significant benefit to these users and would not seem to justify the high costs that preparers would encounter in implementing the proposed model.

Industry-specific reporting is important. Another issue voiced by the venture capitalist representatives was concern over the loss of industry-specific financial reporting standards. Private companies often follow financial statement presentation guidance that is unique to the industries in which those companies operate. These industry-specific reporting methods provide financial information to a user in a manner that best reflects the unique circumstances of an industry. The proposed model should allow private companies the ability to apply industry-specific financial reporting methods.

Proposed model needs to consist of principles, not rules. Importantly, these venture capitalist-users believe that the proposed model should be presented as principles and guidelines rather than rules. If management of the private companies that these users invest in treat the requirements of the proposed model as rules in preparing their financial statements, those statements may become less relevant and useful to the venture capitalists.

Private company surety-user viewpoint based on PCFRC discussions and available input.

Benefits of proposed model to sureties. Private company surety-users find the proposed model beneficial in that they will gain additional information about a company's divisions or segments. The proposed model will provide a greater level of financial reporting detail and additional insights into the performance of a construction company's individual operations. These are important benefits to surety-users because they do not have the access to information and management that other private company users, like lenders, enjoy.

Costs to comply with the proposed model. The proposed model will require sureties to incur significant costs in revamping their systems to accommodate the new financial statement format. Every surety-user has its own modeling processes and underwriting analyses that will need to be overhauled. Moreover, vendors that provide analytical tools to agents and surety-users will be asked to incorporate the new model into their products, thereby incurring further costs.

Industry databases. Like lender-users, sureties utilize industry statistics in their comparative analyses. For example, the Construction Financial Managers Association maintains an extensive database of industry averages, ratios, and other statistics going back many years. Costs will be incurred to revamp these databases.

GAAP exceptions. Surety-users are concerned that smaller construction contractors would be inclined to save costs and not adopt the new model (GAAP exception) unless the surety-user required it. Sureties would most likely allow GAAP exceptions initially, but after one or two years, no exceptions would likely be allowed.

Private company preparer and practitioner viewpoint based on PCFRC discussions and available input.

Costs to comply with the proposed model. The proposed model will impose a substantial cost burden on private company financial reporting preparers. Those costs include software revisions, disaggregating information, linking financial information between the statements, training and education, and increased audit fees. Given the very poor current economic conditions, the bleak economic outlook, and the inability of companies to sustain additional expense, preparers raise serious doubts about whether the benefits of the proposed model justify the compliance costs.

Preparers state that the proposed direct method of reporting cash flows and reconciliation schedule are prime sources of the cost burden. Furthermore, practitioners will need to test the extra disaggregated information and reconciliation schedule, increasing their costs and having to pass them on to preparers. The cost of preparing the direct method cash flow statement is tied to the level of required disaggregation. A preparer will need to derive the amount of cash that was expended on the variety of expenses that have been disaggregated and reported. Currently, many private company preparers use low cost off the shelf software that does not allow modifications. This software does not facilitate the analysis and break down of accounts payable, accrued liabilities, and other accounts necessary to prepare a direct method statement of cash flows. Accounting and financial reporting software will need to be rewritten to facilitate the preparation of a disaggregated direct method statement of cash flows.

Proposed model fails to incorporate widely-used metrics. Preparer constituents point out that the proposed model does not incorporate or define many important concepts that are currently widely used in practice. For example, many private company financial statement users rely on EBITDA, working capital, and free cash flow metrics. The design of a new financial model should consider integrating these metrics, according to those preparers.

Private company owner-user viewpoint based on PCFRC discussions and available input.

Private company owners and shareholders appear to be mostly concerned with the cost-benefit balance of the proposed model. More cohesive financial statements that provide a greater level of detail are welcome by private company owner-users. However the anticipated costs of the proposed model (as articulated above) are not. Given the cost-savings measures that owners and shareholders of private companies will be looking to implement now and in years to come, they tend to be of the opinion that the benefits of the proposed model do not justify the related costs. In general, private company owners and shareholders would prefer that any such costs be incurred to implement a financial reporting model that more closely aligns with the metrics generally employed in the valuation of nonpublic enterprises (for example, EBITDA, working capital, and free cash flow, as noted above).

Alternatives for private companies

Private company constituents generally believe that one financial statement model for public companies and private companies is preferable. Having both public companies and private companies follow the same financial statement model would avoid possible difficulties and confusion that could grow if the presentation of financial statements is not the same for both sectors. Nevertheless based on the PCFRC's discussions and the input it has received from constituents, the benefits of the proposed model appear to be minimal to numerous private company financial reporting users, especially the key lender user group. These users find that the current model serves them well. They also find that some of the aspects of the proposed model to be detrimental to their decision making. Venture capitalist-users express concern that the high level of proposed changes, additional detail, and restructuring of the financial statements will result in high preparer costs that outweigh the benefits of the proposed model. Added to that is the substantial costs that the proposed model will impose upon private company practitioners and many users.

These facts must be balanced by the fact that some private company constituents, like venture capitalists and sureties, find some aspects of the proposed model beneficial.

Given these responses to the proposed model, the PCFRC believes that the FASB should explore the pros and cons of the two alternatives presented below for private companies. Failure to address the concerns of private companies in this area may result in numerous private companies deciding not to eventually comply with the proposed model and choosing other alternatives than preparing GAAP financial statements.

A potential issue to consider is what choice microcap private companies may make if the proposed model, as currently envisioned, is applicable to them. Faced with having to adopt the proposed model, microcap private companies may choose other bases of accounting besides GAAP, such as IFRS for Non-publicly Accountable Enterprises, rather than incurring the costs of complying with the proposed changes. For a microcap private company, a substantial portion of the cost of obtaining a compilation service could be tied to the financial statement format changes, direct method cash flow statement, and reconciliation schedule.

Alternative 1 - Providing accommodations to private companies. Reductions and changes could be made to the proposed model to accommodate the concerns of private companies and reduce the cost burden upon them and their financial reporting users. Examples of some of these accommodations include:

- Requiring that additional disaggregated information be provided as supplemental information instead of being displayed in the financial statements.
- Requiring a lower level of disaggregation for private companies in the financial statements than currently implied in the proposed model. This accommodation would be especially helpful in the preparation of the direct method cash flow statement, which would be easier and less costly to prepare at a higher level of aggregation.
- Eliminating the reconciliation schedule.

Alternative 2 - Making the proposed model optional for private companies. Numerous private company constituents believe the proposed model is more applicable to public companies than to private companies. The research for the proposed model indicates that public company investors and analysts found the current financial statement model to be lacking and urged the FASB to develop the format presented in the Discussion Paper. This concern does not appear to have been voiced by private company financial reporting users.

Private company lender-users, many venture capitalist-users, and owner-users have regular access to management and financial information not provided in the financial statements. These users are able to discuss with management a company's financial results, strategies, direction, and core assets, among other things. Public company financial statements frequently lack the level of transparency that private company financial statements possess. In addition, private companies' businesses generally are not as complicated as public companies and private companies already tend to provide more information in their financial statements than public companies do. Given these factors, lender-users, venture capitalist-users, and owner-users tend to believe that the current financial statement model serves them well.

From the perspective of lender-users and owner-users, the current model provides useful general purpose financial statements while the proposed model provides more special purpose financial statements designed for analysts and sophisticated investors.

To address the concerns of these private company users and the concerns of preparers and practitioners who believe the benefits of the proposed model do not justify its high costs, the proposed model could be made optional for private companies. Being optional, private companies that do business with users who prefer the proposed model could opt to prepare their financial statements in accordance with the requirements of the Discussion Paper. Other private companies whose users prefer the current financial reporting model can maintain their financial statements under the existing format.

Under the alternative of making the proposed model optional for private companies, only the presentation of the financial statements would differ among entities, not the underlying accounting. Moreover, the presentation of the financial statements would be driven by user needs and cost-benefit considerations.

Transition Period

If the proposed model becomes applicable to private companies, a lengthy transition period is necessary. Given the high implementation costs, the time-consuming need to revamp systems to accommodate the proposed model, and the steep learning curve attendant to the proposed model, a longer-than-usual, perhaps staged, transition approach will be in order in the private company sector.

Separation of Activities, Assets and Liabilities in the Financial Statements

(Respondent Question Nos. 2 and 6)

Private company lender-user viewpoint based on PCFRC discussions and available input.

The grouping of assets and liabilities into the separate sections proposed in the Discussion Paper does not benefit lenders who use private company financial statements. Lender-users argue that most private companies have simple financing arrangements and financial statement users can easily tell which assets and liabilities relate to financing. Additionally, lender-users are concerned that separating assets and liabilities into different sections may decrease the connectivity between related balances. In the private company sector, financing tends to be asset-centric, with private companies having lines of credit, long-term mortgages, long-term loans on equipment, and capital leases. Generally debt relates to specific assets and no general obligation debt exists. Lines of credit are closely linked to receivables, inventory, and payables. Analytically, lenders tie those balances together. Separating them into different categories decreases the connectivity between the debt and the related assets.

Private company surety-user viewpoint based on PCFRC discussions and available input.

Surety-users find the Discussion Paper's proposals on categorizing information in the income statement to be a positive development; however the proposed categorizations in the statement of financial position do not hold much value for those surety-users.

The ability to understand which items of income and expense are generated by the core business of an entity and other areas is helpful to sureties. However, the required categorizations and segregations of assets and liabilities in the statement of financial position would not be as important to them. Liabilities have to be paid, no matter where they are classified. Similarly, cash is cash

Surety-users may convert the new statement of financial position back into the traditional model for purposes of analysis. This is because those users are used to the traditional format and converting back to the traditional model would facilitate comparative analysis with prior years' data. After an initial period of unfamiliarity with the new model, users would likely stop converting the financial statements back to the traditional format.

Private company venture capitalist-user viewpoint based on PCFRC discussions and available input.

Similar to surety-users, venture capitalist-users find the proposals related to the income statement to be a positive development. The restructuring of the statement of financial position does not appear to be of much benefit to these users and would not appear to improve their analysis of a private company's financial statements.

Private company preparer and practitioner viewpoint based on PCFRC discussions and available input.

Some private company preparers indicated that the proposed separation of business activities from financing activities would provide more decision-useful information to them. CEOs and CFOs currently utilize EBIT or EBITDA to measure business performance. By definition, those measurements separate out financing and tax from operations. Some preparers indicated a desire to see widely-used terms like EBIT and EBITDA defined and incorporated into financial statements.

> In addition, some private company preparers stated that one of the most widely-used and useful terms in the private company sector is working capital. This concept has not been defined and incorporated into the proposed model. One objective of the proposed model is to improve the assessment of liquidity and financial flexibility. Measurements such as working capital and the current ratio help achieve that objective. Some preparers suggested that a better statement format would display short-term assets and short-term liabilities, with a sub-total of working capital. Then, long-term assets and long-term liabilities could be layered in.

Disaggregation of Financial Information

(Respondent Question Nos. 16 and 4)

In general, private company financial statement users prefer more detail in the financial statements. As such the objective of providing more disaggregated financial information is an improvement for private company constituents. However, some concern exists over the cost-benefit balance in requiring substantial disaggregation.

Surety-user viewpoint. Surety-users tend to find the proposed additional detail in the income statement useful. The additional granularity would help a surety-user better identify which activities of an entity generate profits and losses and whether the core business activities of an entity are profitable or not. In addition, surety-users find more information about the sources and uses of funds to be helpful in their decision making.

Lender-user viewpoint. Lender-users cautioned that many users of private company financial statements already obtain detailed, disaggregated information from the preparers as supplemental schedules. Private companies don't have the same restrictions on providing information to financial statement users as public companies do. There is greater transparency in the private company sector (users often maintain a dialogue with management). If users of private company financial statements already have access to detailed information, then having preparers incur the costs of providing more disaggregated information in their financial statements will not provide sufficient benefits to users.

Venture-capitalist-user viewpoint. These users held opinions similar to the surety- and lender-users in that more disaggregated information in the income statement would be an improvement, however too much information could muddy the presentation. Like lenders, many venture capitalist-users have ready access to management and additional financial information as they require it.

Preparer and practitioner viewpoint. From the private company preparer's perspective, the costs that they will incur will increase as the level of disaggregation is increased. Every new line item will need to be run through each financial statement and be included in the reconciliation schedule. Practitioners will need to test the additional data and line items, increasing audit and accounting fees. Increased costs will discourage private company preparers from providing much disaggregated information.

Discontinued operations. In addition to the above points, the Discussion Paper does not require enough disaggregation for the presentation of discontinued operations. A financial statement user will not be able to distinguish between current and long-term liabilities in the discontinued operations section.

The Management Approach

(Respondent Question No. 5)

Preparer viewpoint. Private company financial reporting preparers are generally in favor of the proposed management approach. Preparers contend that being the parties most knowledgeable about a reporting entity's business, they are in the best position to make judgments about the classification and presentation of items in the financial statements. The management approach offered in the proposed model would allow preparers to communicate accurately the financial performance of an entity.

Lender-user viewpoint. On the other hand, lender-users believe that the proposed management approach in the Discussion Paper allows management too much discretion and may result in financial reporting inconsistencies between companies within an industry, leading to a decline in standardization and a lack of comparability.

Lender-users believe that under the proposed guidance, identical facts and circumstances could be presented differently by various management teams, without industry norms or guidelines about how to categorize similar items. If that occurs, extensive industry databases depended upon by financial reporting users may lose significant analytical value because of the great degree of flexibility granted to management in categorizing assets and liabilities.

Venture capitalist-user viewpoint. Concerned that management of private companies continue to have the flexibility necessary to report financial information in the most useful manner, venture capitalist-users stress that the management approach in the proposed model should be in the form of guidelines and principles and not rules.

Practitioner viewpoint. Private company practitioners point out that disagreements between management and their practitioners over classification issues may multiply under the proposed management approach. And, when companies change CPA firms for their attestation and accounting services, inconsistency in financial statement categorizations may grow as a new practitioner may judge financial statement categorizations and presentations differently, lacking clear guidelines.

Direct Method of Reporting Cash Flows

(Respondent Question Nos. 19 and 20)

Many of the private company financial reporting users that the PCFRC has been in contact with find the direct method of presenting cash flows to be an improvement, as connectivity between financial statements is enhanced and a clearer picture of the sources and uses of funds is achieved. However, the venture capitalist-users that the PCFRC received input from did not believe that the direct method of reporting cash flows would provide a significant improvement to their decision making.

Preparing a direct method cash flow statement will be costly and time-consuming for private companies and problematical to prepare accurately if a significant level of detail is required. Input received by the PCFRC from preparers indicates that the incremental cost of re-engineering systems to provide the necessary data, coupled with the likely increase in audit expense would, in the preparers' viewpoint, exceed the limited benefits expected from the direct method of reporting cash flows. Private company owner-users also may find that such costs outweigh the benefits.

Even if the perceived benefits were deemed to justify the incremental implementation costs, preparers of private company financial statements are skeptical as to whether their specific method of preparation and presentation of the direct method will sufficiently match the expectations of the users of those financial statements. An expectation gap of this nature could result in a diminution of the perceived benefit, as users would continue their existing practice of converting the statement of cash flows into the format they most prefer; yet the additional preparer costs associated with the direct method would still persist.

Reconciliation Schedule

(Respondent Question No. 23)

Preparing the proposed reconciliation schedule will be costly (IT systems modifications, audit fees, etc.) and time-consuming for private company financial statement preparers.

Lender-users do not see a need for the reconciliation schedule and find that a direct method cash flow statement would meet their needs.

Surety-users may find useful information in the proposed reconciliation schedule, but it is hard to predict if the schedule will ultimately prove useful. The initial learning curve will be painful as surety-users try to understand the information in the schedule. Those users will have many questions of management and the CPA practitioners about the items in the schedule, especially the items related to remeasurements.

Venture capitalist-users believe that the high cost of preparing the proposed reconciliation schedule to the companies that they invest in would substantially outweigh any benefits that the schedule might offer to users. Also, the proposed reconciliation schedule could be confusing to less sophisticated users of private company financial statements and may ultimately require additional disclosures in the notes to explain the data in the schedule.

Cash Equivalents

(Respondent Question No. 12)

The proposed model would have cash equivalents presented and classified in a manner similar to other short-term investments, not as part of cash. This requirement would run contrary to the way many private companies manage their cash. Private companies often make use of sweep accounts (for example, overnight deposits and repo sweeps) to effectively manage their cash and earn a higher return. As such, if the proposed requirement were in place and only demand deposits and cash on hand were classified as "cash", many private companies would not have an amount presented as "cash" on the statement of financial position The PCFRC's preparers, practitioners, and users are in agreement that such a presentation would not be beneficial and would be somewhat misleading .

Therefore, the PCFRC suggests that the proposed model allow cash equivalents to continue to be combined and presented with cash on the statement of financial position. In addition, the proposed model should require that information about the amounts and kinds of cash equivalents presented in the cash line item be disclosed in the notes to the financial statements. If the FASB decides that cash equivalents should be separately presented from cash on the statement of financial position, then the PCFRC suggests that the cash flow reconciliation be done to the combination of cash and cash equivalents.

Other

The PCFRC brings the following other items to the FASB's attention:

- Surety-users are concerned that interim reporting will be negatively affected by the proposed changes, at first. Currently, sureties find it challenging to tie in interim contractor financial statements to the annual statements. A new model will exacerbate the problem, when it is first adopted.

- The PCFRC believes that important subtotals and totals (for example, current assets or total liabilities) should be displayed on the face of the statement of financial position and should not be only disclosed in the notes to the financial statements. Many private companies prepare financial statements without disclosures. This would help a financial statement user's analytics.

- Guidance is needed on how the proposed model would apply to unique industries (for example, those that follow FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*).

The PCFRC appreciates the FASB's consideration of these comments. As we receive additional input from our constituents, we will work with that information and provide the FASB with additional feedback, as appropriate. Additionally, the PCFRC stands ready to help the FASB with any additional research that the FASB may wish to conduct on this project in the private company sector. Please feel free to contact me if you have any questions or comments.

Sincerely,

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