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

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

Re: Proposed Statement of Financial Accounting Concepts – Conceptual Framework for Financial Reporting: The Reporting Entity ("Reporting Entity Exposure Draft")

Dear Mr. Herz:

The PCFRC has reviewed and discussed the Reporting Entity Exposure Draft and offers comments and recommendations below.

Responses to Specific Questions asked by the FASB in the Exposure Draft

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

   PCFRC Response: The definition of a "reporting entity" in paragraph S1 of the Exposure Draft (as stated in Question 1 above) is in need of clarification and change. Only referring to equity investors, lenders, and other creditors in the definition fails to encompass other financial statement users. In addition, the current wording may suggest to some readers that many private companies would be scoped out of the definition. As such, the PCFRC suggests the following rewording of the definition:

> "A reporting entity is a circumscribed area of economic activities whose financial information may be useful to existing and potential financial statement users. These users may not be able to directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether the management and the governing board of that entity have made efficient and effective use of the resources provided."

In addition, the PCFRC believes that in the private company sector flexibility is needed in determining the composition of a group reporting entity and in defining a circumscribed area of economic activity. A basis for determining the composition of a group reporting entity should take into account all relevant considerations. The legal ownership and composition of entities is important to the users of private company financial statements. For example, users may not have access to the cash flows of entities that may be consolidated into a potential group reporting entity but are outside the legal composition of the reporting entity. As such, including the assets, liabilities, operations, and cash flows of such an entity in the financial statements of the reporting entity would not be decision-useful to the user of the reporting entity's financial information.

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

   <u>PCFRC Response</u>: The PCFRC believes that consolidated financial statements do not always provide useful information to private company equity investors, lenders, other capital providers, sureties, and insurers. As stated in the PCFRC's July 18, 2008 letter to the FASB, 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. The PCFRC believes that stand-alone, parent-only financial statements should be allowed under generally accepted accounting principles ("GAAP") for private companies. Accounting standards should be flexible to accommodate diverse financial statement users' needs.

   In presenting stand-alone, parent-only financial statements, the parent's investment in the other entity or entities would be accounted for under the equity method. Summarized information as to assets, liabilities, and results of operations of the investee would be presented in the notes. Such parent-only financial statements would continue to contain adequate disclosures about related-party entities and activities. Furthermore, a financial statement user would not be precluded from obtaining the financial statements of entities controlled by the parent.

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 from the cost of preparing consolidated financial statements, 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 (two PCFRC members dissented from the PCFRC's recommendation about parent-only financial statements)

These PCFRC members do not believe that stand-alone parent-only financial statements should be GAAP for private companies. These members think that not consolidating entities that are controlled by a parent company could mask potential risks and rewards to the consolidated group. Users could also be deprived of disaggregated information about revenues, expenses, and cash flows under a "one-line" consolidation proposed above. Management producing stand-alone parent-only financial statements could chose to mask relevant financial statement amounts in the equity method balance through intercompany transactions.

An example of these concerns comes from the surety world. Full disclosure in a bond principal's financial statements is paramount to a surety's ability to underwrite effectively. A private company exception to Accounting Standards Codification ("ASC") subtopic 810-10, *Consolidations*, (FIN 46(R)) is contrary to this interest. Private companies should not be exempted from the basic principles of consolidation as enunciated in ASC subtopic 810 (Accounting Research Bulletin No. 51), 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. Accordingly, it is expected that reduced disclosure will become the norm, creating adverse effects for sureties, which would outweigh any cost savings.

Combined Financial Statements

The PCFRC believes that clarification and guidance is needed about when combining financial statements are appropriate. Often in the private company sector, an individual may own multiple entities. Uncertainty exists about what types of combined financial reporting are acceptable.

Paragraph RE12 of the Reporting Entity Exposure Draft states the following:

> "Combined financial statements include information about two or more commonly controlled entities… Combined financial statements might provide useful information about the commonly controlled entities as a group."

Section 810-10-55-1B of the ASC states the following:

> "Combined financial statements might also be used to present the financial position and results of operations of entities under common management."

Based on the above citations, the Reporting Entity Exposure Draft states that combined financial statements may be appropriate for entities under common control while the ASC states that combined financial statements may also be appropriate for entities under common management. Therefore a conflict appears to exist between the Reporting Entity Exposure Draft and the current ASC.

The PCFRC agrees with the definition of control of an entity.

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

   PCFRC Response: The PCFRC agrees. Furthermore, the PCFRC believes that any legal entity should qualify as a reporting entity. In those cases, all appropriate disclosures should be required to prevent the financial statements of the legal entity from being misleading.

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

PCFRC Response: The PCFRC believes that the Reporting Entity portion of the Conceptual Framework should be completed before the FASB and IASB develop their standards on consolidation

We appreciate the FASB's consideration of these comments and recommendations. Please feel free to contact me if you have any questions or comments.

Sincerely,

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