



National Venture Capital Association

August 14, 2006

BY EMAIL

*www.pcfr.org*

Technical Director--File Reference 1310-100  
Financial Accounting Standards Board  
401 Merritt 7  
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Norwalk, Connecticut 06856-5116

***Re: Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies***

The National Venture Capital Association is pleased to support the FASB's and AICPA's June 8th joint proposal on Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies.

NVCA represents the vast majority of American venture capital under management.<sup>1</sup> We represent the interests of both users and preparers of private company financial statements – the individual venture capitalists who make up VC firms, the firms themselves, the funds these firms form and manage and the private companies in which these funds invest.

Nearly every NVCA member firm is a private entity owned by professional venture capitalists. The firm prepares financial statements for the use of its members and 3<sup>rd</sup> parties such as financial institutions that provide credit for firm operations or capital investments.

As noted, NVCA member firms organize and manage venture capital funds which make equity investments in development-stage operating companies. The majority of the investment capital in each fund comes from limited partner investors (“LPs”), the majority of whom are pension funds, foundations, endowments, insurance companies and

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<sup>1</sup> The National Venture Capital Association (NVCA) represents more than 450 venture capital and private equity firms. NVCA's mission is to foster greater understanding of the importance of venture capital to the U.S. economy and support entrepreneurial activity and innovation. The NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provides reliable industry data, sponsors professional development, and facilitates interaction among its members. For more information about the NVCA, please visit [www.nvca.org](http://www.nvca.org).

other institutional investors. Typically venture capital funds (“VCFs”) are private investment entities, exempt from SEC investment company regulation. In some accounting contexts, they have been called “unregistered investment companies.” These funds prepare financial statements primarily for the use of their LP investors.

The use of FASB standards to prepare venture capital fund financial reports is driven by investor demand for uniform, timely, reliable and useful financial information. While VCFs are free to provide financial statements that vary from GAAP, many VCF’s partnership agreements provide that financial reports be prepared in accordance with GAAP.

Venture capital funds are also among the primary users of the financial statements of the private operating companies in which they invest. These financial statements are usually prepared according to GAAP and audited by an independent CPA firm.

### **There Is Need for Special Attention to the Impact of FASB Standard on the Financial Statements of Private Entities.**

NVCA has regularly participated in the development of FASB standards and pronouncements that have an effect on private company financial statements of VC firms, funds and portfolio companies. Among the standards that we have commented upon are FAS 123R on stock options accounting, the pending FAS 15X on fair value measurement, EITF No. 04-5 on consolidation of limited partnerships, and FIN 46 on consolidation of variable interest entities. While many of these changes to GAAP were driven by circumstances in the publicly traded company environment, each had or may have had a significant impact on private entities.

The process by which the FASB made each of these changes raised serious concerns in the venture community as to whether the FASB had adequately considered the effect they would have on private company financial reporting. Indeed, in at least a few cases the outcome of the standard-setting process made the GAAP financial statements of venture capital entities less relevant and less useful. Therefore, we clearly see the need for improvement in the way FASB sets standards so that it more clearly and deliberately considers their effect on private company financial reporting.

NVCA supports the key parts of this proposal. In our comments below, we offer suggestions on how to further enhance the standard-setting process for private companies and how to improve the effectiveness of the proposed Committee by clarifying its purpose and increasing its independence.

### **We Support Changes to FASB’s Standard-Setting Process That Will Enhance its Sensitivity to Private Company Impacts.**

We agree that the accounting standards for private companies should be based on user needs and cost-benefit considerations. Our experience with a number of FASB

standards has been that for private entities in the VC community the cost of implementing new standards exceeded the benefits to the users of those statements. We believe a more robust cost-benefit analysis of proposed standards would benefit not only private companies but all FASB constituencies.

The SEC has recently begun to use the tools of the economics profession in analyzing its rule proposals.<sup>2</sup> Following the SEC in this trend would assist the FASB in ensuring that key cost-benefit conclusions are based more on fact than conjecture. The completion of an actual economic analysis would make it possible to publish the Board's basis for concluding that the benefits of a new standard exceed the costs. This transparency would enhance the effectiveness of the overall standard-setting process and provide affected constituencies a basis upon which to comment on cost-benefit issues.

A different cost-benefit analysis may well be appropriate regarding the impact of standards on private companies. This issue could certainly be a matter for inquiry and dialogue between the FASB and users of such statements. Venture capital fund LPs are primarily large investment funds with a high level of sophistication about venture investing. The kind of information they find useful in VC fund financials may well be different than the information they seek regarding publicly traded companies or funds that invests in them.

### **We Support the Establishment of a Committee to Promote Constituent Input into the FASB Standard-Setting Process.**

A Committee made up of the best members available would surely improve the level of constituent input into the standard-setting process and provide the best recommendations to FASB. We believe that the independence of the Committee will be an important variable in attracting the most qualified volunteers. Therefore, we strongly agree that the Committee should set its own agenda and priorities.

The Committee's autonomy has inherent limits due to the fact that FASB and AICPA will be providing all of the financial support, will be its appointing and nominating authority, and will likely name the Chair. In order to enhance the Committee's autonomy against this practical backdrop, we urge that the Committee's mission and authority be stated so that it is clear that the FASB intends to give the Committee substantial independence.

We see significant room for improvement in the Committee proposed "charter." We think changes to these basic Committee purposes will assist in recruiting top-notch members and will improve the Committee's work. We note that paragraph 24 of the

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<sup>2</sup> BNA SECURITIES LAW DAILY, *Glassman Says Court Decision An Affirmation of "Economists" Approach*, July 7, 2006. ( Departing SEC Commissioner Cynthia Glassman told the Nation Economists Club of Washington: "I do believe [the SEC is] beginning to produce more robust cost-benefit analyses, and we are exhibiting increased sophistication both in the description of the economic impact of our actions and the level of arguments based on economic analysis.")

Invitation to Comment (“IC”) says that the Committee should be allowed “a certain level of autonomy.” We believe that FASB and AICPA would have a better chance of attracting top-level participation if it were clear that the Committee would have a *significant* level of autonomy *within the parameters established by the FASB and AICPA in its mission.*

The Committee will be more effective if it has a clearer mandate and a broader scope. Rather than speak in generalities, we hope it will be helpful to provide some specific examples of the kinds of changes we would recommend.

- The Committee’s “mission” set out at IC, paragraph 21 is: “Provid[ing] recommendations that will help the [FASB] determine whether there should be differences in prospective and existing accounting standards for private companies.” This seems much more of a function than a mission. A more goal-oriented mission would give prospective members better assurance that their time will be well spent. Certainly, the FASB and the AICPA should determine the Committee’s mission. However, we recommend that the mission be worded more like the following:

*Assist the FASB in ensuring that private company financial statements are useful to users and are prepared in a cost-efficient way by providing insights and recommendations as to the need for differences in specific accounting areas such as recognition, measurement, disclosure and presentation.*

Similarly, we would revise “objectives” 1 through 3 (IC, paragraph 22) to be more concrete and less process driven. Paragraph 22 provides useful guidance as to what the FASB and AICPA expect of the Committee. However this is guidance as to activities for the most part, not objectives. Genuine objectives would provide a basis for building consensus and provide criteria for evaluating the Committee’s effectiveness. The objectives set forth in paragraph 22 could be re-written to be a clearer statement of an actual objective to which the Committee could refer as it did its work.

- Objective 1 could read: *The Committee will establish its own interpretation of user needs and cost-benefit considerations that are most relevant to private companies and communicate them to the FASB.*
- Objective 2 and 3 could be combined to read: *The Committee will establish an open, public due process for evaluating new proposals and existing standards and will have a formal dialogue with the FASB, including, at a minimum, Committee recommendations and FASB responses.*

Finally, we agree that periodic reviews of the Committee’s effectiveness would be appropriate. This review should be based on clear criteria of effectiveness, which should include both process and substantive goals. A formal review with opportunity for

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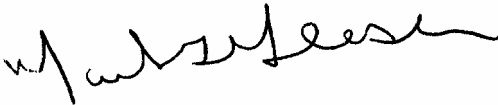
discussion with the Committee would be most consistent with the Committee's autonomy.

We also recommend that the Committee be given sufficient time to prove its value. It may be appropriate to establish a fixed initial life of perhaps three years. We also believe that Committee members should serve for fixed terms. Similarly, the part-time chair should serve for a fixed term and renewal of his or her term as chair should be subject to the approval of the Committee.

### **Conclusion**

NVCA supports the Joint Proposal and stands ready to assist in its implementation. We believe that this effort has potential to make a significant improvement in accounting standards for private companies. We urge the FASB to seriously consider the recommendations we have proposed. While our suggestions are only examples, we do believe that the Committee's work will be improved by a greater sense of autonomy within a clearer goal-oriented mandate from the FASB and AICPA.

Very truly yours,

A handwritten signature in black ink, appearing to read "Mark G. Heesen". The signature is fluid and cursive, with a long horizontal stroke at the end.

Mark G. Heesen  
President