

To: CommentLetters
From: Marc C. Hendrikson

I would like to comment in general about this proposal, then I will address the 5 specific questions listed for respondents to answer.

I am a commercial lending officer for a community Bank in Denver, CO as well as a CPA, having spent my entire career in banking (nearly 2 decades), in the areas of operations, accounting, financial reporting, budgeting, and most recently in business credit and lending (last 10 years). My client base is entirely made up of small, closely held, private companies who have lending needs of less than \$10M and revenues of less than \$20MM. Outside of my top 10 clients, the majority of remaining clients fall well below \$1M in lending needs and \$5-10M in annual revenues. As such, my perspective is more limited and much simpler in scope than that of a user in perhaps a larger, more sophisticated environment.

In general, few clients of our institution are required to obtain annual audits (10% or less), more clients obtain reviewed statements, most clients get compilations and many others simply submit tax returns and company prepared statements, which may or may not be GAAP compliant.

As the borrowing needs and amounts increase, the reporting requirements become more onerous by us and/or bonding agencies, suppliers, etc., but most do not have sophisticated reporting mechanisms in place, or cannot cost effectively produce GAAP compliant statements. Again, depending on the lending needs, size of company, scope of operations, etc. we are generally ok with basic statements, sometimes GAAP compliant, often just "close enough."

Ironically, I have several clients who must obtain reviewed or audited statements for parties other than the Bank since we are comfortable with the internal process and/or just a compilation, get monthly internal numbers that suffice, and we cannot competitively require more than that since other lending institutions often do not require better reporting.

As long as a client is posting even modest profits and/or the collateral is sufficient and there is backup capacity with owners of the company or through related entities, the credit analysis is very straightforward and "pierces" through to the heart of the strengths and weaknesses of the core operating company's financial situation, irrespective of the form the reporting takes. Even if losses ensue, if the reporting is accurate to our estimation, a different type of report typically will not change that reality by any material amount. If material issues arise related to GAAP or any other issues in the reporting process, then we attempt to address those situations directly and specifically - not generally, at which point the CPA is called in to help facilitate better reporting.

As an example of onerous and fairly useless information to us as lenders is the FIN46 requirement for consolidating related entities. Most of the time, we are aware of the most common types of related entities, such as real estate or equipment LLCs that are used to house

other assets, provide legal protection, or for estate planning outside of the operating company. We obtain that information through our own due diligence via interviews and personal financial statement gathering and are often involved in those activities as well, particularly in financing real estate or specific equipment financing.

In many cases, equipment manufacturers or other large institutional lenders may offer more favorable financing terms, which would cause those assets to be pledged elsewhere, thus are not available. Thus, the consolidation often confuses the operating results of the main company.

If the assets are free and clear, this is an added strength, but if housed under a separate legal entity and the main operating company is strong, the borrower will not likely offer them as collateral anyway, so again the additional reporting does not satisfy anyone's needs at that point.

In the case where there is a foreign operation, such as in Canada or Mexico, we typically only want to see the operating company's results because we often cannot perfect collateral in other countries, won't lend into those foreign operations, and the elimination of intercompany A/R & A/P removes valuable information that we need. For example, the Bank may actually want to restrict the amount company "A" lends company "B" or the owner who is financing it to protect our collateral position and credit interests. In this case, FIN46 actually does us a dis-service.

In any event, if a company wants to hide assets, debt, or losses, then GAAP cannot fix this as evidenced in recent high profile cases. I too, experienced fraud that caused the failure of a 98-year old company with multiple national and international branches. Nothing short of a miracle would have prevented the fraud that took place in this case, which even the receiver (a CPA by the way) did not discover until late in the workout process during the brokering of a sale of the business. The company failed because the owner and controller were able to hide major losses, largely due to inherent internal control weaknesses and collusion as well as the lack of key accounting modules that had never been purchased (through MAS 90), enabling them to "create" fictitious A/R reports (our collateral). Ironically, to our best estimation, this all occurred during the last months of the life of the business, something that the external CPA could not have known during the review that was done the year before, when things were still "ok." Again, the unraveling of a business and faulty reporting cannot be categorically fixed by GAAP or additional provisions thereof. Good reporting occurs based on the honesty and integrity of a business owner, not rules and regulations. GAAP should be a guideline, albeit strict, but not an enforcing mechanism.

Again, we as small business lenders are mostly analyzing the raw operations first, then looking to outside entities for strengths and/or weaknesses, but this type of consolidated reporting at FYE often confuses the issue, particularly when we get monthly statements of the operating entity that exclude the other entities; thus, FIN46 has been known to cause unnecessary covenant violations when a R/E or equipment entity is thrown into the mix that might be heavily leveraged, often with outside creditors (again, we usually do our due diligence in this

matter and get that information from the clients irrespective of FYE reporting).

In the case of contractors, under and over billings via contract status reports are the most important aspect of reporting along with A/R & A/P, but again, only if the operation is large enough to make this reporting meaningful. In many cases, cash basis or simple accrual accounting is sufficient to give us a big picture of the operations, i.e. when jobs are completed in a short period of time and are not large enough to be reported at FYE, depending on the cash flow of a specific project. As for contract status reporting, this can be greatly skewed since the original bid price of a job is not reported, only the current revenue stream along with profits or losses as they occur - and losses can occur in a later year, further skewing the overall reporting (or hiding of problem jobs).

It is my opinion that unless a company has major borrowing needs along with a sufficiently sophisticated operation with multiple branches and/or other entities that could cause the reader of financial statements to be misled without further consolidation or specific GAAP requirement that a similar public company would have to comply with, the process of forcing them to comply with "big" GAAP is unreasonable, unwarranted, and in many cases downright confusing, skewing the financial picture of the main operating company.

Specifically, in the case where audited or reviewed statements are not prepared, many companies are not purely GAAP compliant anyway with the CPA making minor adjustments at FYE to get to an accrual statement with no further work done and this is fully acceptable and understood by most small business lenders.

For the most part, unless a company hits a certain threshold, whether in revenues or borrowing needs (each institution sets its own guidelines in this arena as does the FDIC and the OCC), the reporting does not have to be overly sophisticated for the lender to figure out what's going on.

In some cases, fund accounting, cash basis or OCBOA (tax return or other) are even more appropriate, such as with non-profits, smaller medical practices and smaller contractors who only report revenues when the cash is received along with a supplemental A/R schedule attached to the FYE statements - again sufficient for the lender to make a quick, but informed decision along with other items (personal financials, tax returns, etc.).

Quite frankly, it has been my experience that most lenders (except for those in large commercial lending departments with sophisticated credit administrators that are lending to very large and sophisticated borrowers) do not have a good comprehension of GAAP in the first place and are mostly reliant on the information the client provides to get back to a mostly accrual based assessment of the financial position. Unless there are obvious issues in reporting or fraud is suspected, or major losses are occurring among many other things we look at to detect credit issues, the CPAs role, while key, is minimal, perhaps an annual exercise at most and not even GAAP driven in many, many cases.

Finally, in this regard, most small business lenders find the ongoing FASB and other pronouncements confusing and not necessarily helpful and

they really do not keep up with them nor do they have a meaningful understanding of them. The foundations of good reporting, accrual accounting and the like are understood, beyond that, we begin to get frustrated and lost with the reporting process. To unnecessarily enhance this process for smaller, private companies without conclusive and material results is a waste of time in my opinion.

Specifically addressing your questions are my responses below:

1) Not generally. I believe whatever changes might be proposed should occur only after as much outside input as possible is obtained, whether from lenders, sureties, suppliers, etc. Keeping the discussion at a "big picture" level will hopefully keep FASB from getting too bogged down in the detail of specific pronouncements until such time as those are warranted or truly beneficial. The investigative piece of this should be as open as possible with the end-user in mind, to get as much input as possible before getting to the detailed level of any pronouncements. I would also add that aside from my CPA connection, I was not aware of the deadline for these responses as a lender, i.e. I do not call specific information being requested from the banking industry or from the CPA profession to the banking industry in this regard.

2) At this juncture, I do not. Furthermore, I cannot see that any specific changes have been offered yet from the proposal that I read. Again, more data should be gathered from users to determine if a need really exists in the first place to improve existing reporting mechanisms for private companies.

3) Absolutely! See above. The onerous nature of reporting becomes self defeating as the cost goes up, particularly of the materiality threshold cannot be met. Privately owned banks for example, particularly S Corps, must keep separate records for tax and regulatory purposes, which causes us great consternation. An example of a recent FASB pronouncement that causes much confusion is the requirement that banks amortize loan fees over the term of the loan, which over time often pay off early causing earning results to be skewed compared to cash flow from fees generated each year. In a commercial institution that lends monies mostly short-term (< 5 years on an aggregate basis) this process mostly creates a wash and does not greatly enhance reporting in my opinion. In most cases, it creates a large number of smaller deferred revenue items that are taken as income in later years when the loan is no longer on the books. A perfect example of reporting that does not make sense in my opinion, based on the size of the institution and the materiality of the items.

4) Unless a meaningful group of volunteers cannot be put together, I would think compensation is a non-issue. However, time is valuable and some modest remuneration might be appropriate. This is a FASB call.

5) Of course. However, please ensure that the goals and outcomes are as a result of and for the benefit of the readers and users of financial statements, not FASBs goals in and of itself. This should be based on a common sense approach.

Thank you for your time and I apologize if this email is a bit long.

Respectfully,

"We put you first by exceeding your service expectations every day"

Best Regards,

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Vice President, Citywide Banks