

September 15, 2010

RE: Responses to Blue Ribbon Panel's questions

Sent by email to tswoo@fasb.org

Dear Sir or Madam:

The Committee on Private Company Standards (CPC-S) of Financial Executives International (FEI) wishes to express its views on the questions from Blue Ribbon Panel. Please see the following responses to the questions.

FEI is the leading advocate for the views of corporate financial management in the United States. It is a professional association of more than 15,000 CFOs, treasurers, controllers and other senior financial managers. CPC-S is a technical committee of FEI which formulates private company positions for FEI in line with the views of the membership. This letter represents the views of CPC-S and not necessarily the views of FEI.

Users (e.g., lender, surety, investor, owner) only:

2. a) Briefly describe how you use GAAP financial statements in your decision-making concerning private companies.

The most common use we have for GAAP financial statements is to evaluate the credit worthiness of customers. We are unsecured creditors. We also use statements to evaluate acquisition candidates, to determine the amount of funds that our companies may physically invest and lend to other companies, to hold those companies accountable as stewards for our funds that we invested or loaned or for the credit that we extended, and to evaluate the stability of these companies.

There are many varied uses we have for GAAP financial statements but using them as a proxy for firm value or exit value is not high on the list if it is on the list at all. That type of analysis, for instance a proposed sale of the entity, would require a different analysis of the market factors that would affect value. The external market factors may influence value more than internal company transactions, assets or liabilities. Exit decisions are often about timing of the exit, not content of the sale. Private company owners and statement users tend to hold their investments rather than trade them or constantly evaluate their value. The non-transient nature of the investment gives private company statement users a different perspective than equity investors in a public enterprise.

When we evaluate companies for credit, acquisition or other investment reasons, we use the financial statements as an integral part of the evaluation process. However, audited GAAP financial statements are secondary to other financial information that we are readily able to obtain if we choose to request such information for our own decision-making purposes. This other financial information consists of (a) payment histories and credit information, (b) more detailed and timely existing historical data, or (c) forward-looking financial projections that the reporting entity may provide or that we, as users, may prepare.

In regards to the other more detailed and timely historical data, its usefulness to us lies almost exclusively in evaluating the following:

(1) The past *operational* earnings on an accrual basis of the entity as a proxy for past cash flow generated from those *operations*, and

(2) How well these reported historical operations of the entity compare to the projections *previously made*, by the reporting entity or by us, for those time periods.

Related to this process, the usefulness of audited GAAP financial statements to us, as users, is to provide a higher level of credibility to the other, more useful and timely historical information that we analyze and rely on for evaluating (1) and (2) above. Specifically, this credibility provided by GAAP statements consists of a reasonable level of comfort that the other more useful and timely historical information:

- has been prepared reasonably free from material error,
- has been at a macro level, at least once a year, “trued –up” by an external party, and
- is consistent and stable in the application of established principles from year-to year.

However, the usefulness of audited GAAP statements only occurs when the *contents* of the statements, as governed by GAAP, aligns with our evaluation needs stated in (1) and (2) above. When GAAP does not address these (our) user needs, then aligning the GAAP statements to the other more detailed information that does meet our needs becomes difficult and in some cases impossible to do. The result is that the credibility added by audited GAAP statements is impaired (or even lost). A certification, or “stamp of approval”, of audited GAAP statements is meaningless if the content is not useful other than to check a box for ‘GAAP statements prepared and received’. Having an audit stamp of approval for information is expensive. Paying for the stamp and receiving information that is not decision useful for users is a waste when compared to getting a stamp on more useful information.

The higher level of credibility given to this detailed historical data from the process of obtaining audited GAAP statements also helps form a base-line for developing forward-looking financial projections. Again, these projections focus on the *operational* earning capability from an entity’s operations on an accrual basis, and not on other potential economic events and circumstances. While audited GAAP statements (should) give confidence in the base-line numbers that may be used as a starting point for creating forward-looking projections, the GAAP statements themselves are in no way a substitution for those more extensive, user-focused

projections. The income statement is the most useful statement, followed by the balance sheet.

b) Tell us about any issues or concerns that you may have with respect to the relevance of the information contained in those statements. Please be as specific as possible in your answer.

A creditor of a private company, or the owner of a private company, is not immediately interested in liquidating his investment through a sale. The accounting standards have been moving to a fair value approach which is more relevant to someone concerned with the value of their investment, not the underlying operations of the entity.

While the value of an investment may be more relevant to someone who intends to make a choice whether to remain invested or redeploy the invested capital elsewhere, the underlying performance of the *operations* of the business is more relevant to someone whose investment or credit decision is less transient. With the investment or credit decision fixed, the operations of the business and its stewardship responsibilities to owners, lenders and credit grantors are more relevant information. In granting credit to our customers, we want to see reactions to changing market conditions in the form of cost savings, diversification, asset sales or other operational moves to protect liquidity and future cash flows. When we invest and lend to other companies, we want to be able to see clearly, through an accountability disclosure, how these companies were stewards of our resources during the (past) reporting periods. These moves can be obfuscated by revaluation adjustments to fair market values.

Underlying historical operations and accounting transactions are extremely relevant but those numbers are presented with the same prominence as, and are often mixed with, revaluation adjustments and less credible information that are not relevant to the decision making process.

All respondents:

3. **a) Tell us about any issues or concerns you have with current U.S. GAAP accounting standards as those standards apply to private company financial statements.**

b) Are those issues or concerns confined to one or more specific standards, or are they more systemic?

While there are some standards that specifically add to complexity, we believe the problem is more systemic. The standards that add the most complexity also add the most cost to the process and are often the same standards that are least relevant to users. We believe standards should be based on the needs of users, but not all users need the same thing.

We do believe there are large groups of users who want things that are significantly similar but that there are groups of users with different motivations who view relevance differently. For instance, we believe that users of not for profit entity statements are different than users of governmental agency statements. We believe that users of public company statements have different motivations and concerns than users of private company statements. We believe the motivation of the user is a significant influence in determining their needs.

Not all residual equity investors have the same motivation for their investment. We don't believe it is possible to create a one-size-fits-all set of standards that is relevant to all users. The process of trying to hold together a one-size-fits-all system of financial reporting results in either (a) compromises to the needs of all users or (b) swings of the standard-setting pendulum in favor of one particular user group at the expense of another. We have become too sophisticated as a society of specialists to maintain such an archaic system for the convenience of a few.

c) Do you believe that those issues or concerns are largely confined to private companies, or are they broader? Please be as specific as possible in your answers.

We believe that complexity is a problem shared by all users but public companies have outside regulators that can require additional complexity regardless of cost, value or relevance. Private companies have been subject to changing to a more rules-based accounting model from a principles-based model at significantly higher cost internally, higher audit costs and with no discernable value to the statement users. We do not find private company users demanding the type of changes that have occurred in recent years to GAAP.

User questions to private companies have either remained the same (tell me about the underlying business) or have been about the impact revaluation and accounting changes so they can be removed from cash flow analysis.

Complexity is a real problem for everyone but public companies enjoy access to public capital as a benefit. Private companies and their users do not receive the benefits but have the same costs, which often are higher as a percentage of revenues.

4. What short-term and/or long-term actions do you believe are necessary to address those issues or concerns? Please be as specific as possible in your answer, and explain your reasoning.

We believe that separate standards for private companies based on a separate conceptual framework would make statements more understandable to users and more useful to other users. A conceptual framework would allow for an understanding of the theory on which statements are prepared, and that theory would be based solely on the practical decisions that users of private company financial statements make. We believe this is missing in current GAAP and is needed to improve the understandability and consistency within the statements.

A separate standard setting group should be created to create the conceptual framework from existing accounting theories and codify rules based on that framework. The framework could be called on to fill in gaps when codification was lacking instead of requiring additional rules due to the lack of a framework.

The new standards would not be GAAP-lite or IFRS-SMEs, but standards based on the body of accounting knowledge that exists today filtered to be comprehensive but retain relevance to users.

We believe this process is the same process other countries have addressed in standard setting for private companies and is the US's turn at a SME-like set of standards. Standards for non-public companies based on a conceptual framework, tailored to the US culture and unique circumstances, seem to us to be most appropriate.

We point out that efforts have been made by private company constituents to filter existing standards within the existing FASB/IASB conceptual framework. For example, an AICPA task force identified twelve potentially troublesome standards affecting private companies, and an SME private company working group identified seventeen standards that should be considered for simplification. A careful analysis shows that these standards remain virtually unchanged for private companies. This failed approach to attempting simplification within the existing FASB/IASB conceptual framework does not need to be repeated; we should have learned our lesson by now.

5. a) To what extent, if any, would an SEC requirement for public companies to adopt IFRS at a date certain affect your answers above? Why?

It would make the case for separate private company standards more imperative. Having the SEC require IFRS also assumes that the SEC would approve what IFRS is implemented and any changes to the approved IFRS. The SEC is not likely to approve standards that are inferior to existing public company standards. This would put the SEC in more direct control of all US accounting standards.

b) To what extent, if any, would other outside factors affect your answers above? Which factors and why?

We cannot think of any outside factors that would influence our answers above. The current process of allowing delayed implementation of the same public company rules, with some small modifications to disclosures is not working in the best interests of the private companies or the users of their statements. The implementation delay is appreciated by already overburdened preparers; however, a delay does not address the fundamental needs of private company users, but instead implies that the FASB recognizes that users now have to learn a new standard that they did not request.

6. Is there any other input that you'd like to convey to the Panel?

Yes. Access to capital is only part of the issue. The cost of the capital is another part of the problem. Companies without audited financial statements or without clean opinions pay a premium for capital. Many studies have shown this to be true and many banks have internal guidelines to reflect the premiums when making loans.

The idea of 'except for' opinions or OCBOA statements results in a higher cost of capital. We believe there should be a set of standards that will allow for the 'gold standard stamp of GAAP' and a clean opinion that is accessible to *all* companies at a reasonable cost. Today, that is not true for private companies. There is a large market of private companies that could use the credibility of audited statements prepared under a uniform, user-based set of accounting principles. The reason that they do not do so is due both to cost and to relevance. However, *content* of financial statements does matter to users, and not just a stamp of approval. See our explanation of the use of *content* under question 2 above.

7. Do these responses represent your individual views or are they submitted to represent the views of the organization with which you are associated?

These are the opinions of the Financial Executives International's Committee on Private Company Standards (CPC-S). The CPC-S represents the views of its private company members on standards issues.

Sincerely,



George W. Beckwith, Vice Chair

Committee on Private Company Standards
Financial Executives International