

Private Company Financial Reporting Committee

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Judith H. O'Dell CPA CVA
Chair

October 21, 2010

Ms. Leslie Seidman
Acting Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*
("proposed ASU")

Dear Ms. Seidman:

The Private Company Financial Reporting Committee has reviewed the proposed Accounting Standards Update titled *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. The Committee has chosen to provide its recommendations by answering only the relevant questions in the individual respondent questions in the proposed ASU. The lack of individual answers to the respondent questions should not be perceived as agreement with the FASB's proposed positions related to those questions. In addition, the PCFRC has chosen to restrict the scope of its recommendations to private companies that are not financial institutions as these comments are likely to be most valuable to the Board.

Question 1: Do you agree with the scope of financial instruments included in this proposed Update?

The PCFRC's role in the standard setting process is unique in that its mission is to evaluate proposed accounting standards with an especially strong focus on whether the proposed standard will benefit the users of private company financial statements and whether the benefit properly outweighs the cost of implementing the proposed standard. **After carefully considering the proposed ASU through a user needs/cost-benefit prism, the PCFRC recommends that nonfinancial institution private companies be exempted from the scope of the proposed ASU.**

The FASB's proposed approach of requiring fair value measurement as the default accounting method for almost all financial instruments is unsuitable in the private company sector. The accounting for financial instruments should portray economic substance and reflect an entity's business strategy, the manner in which financial instruments are managed, and expected cash flows. Management's intent is key. If the intent is to hold an instrument for collection or payment of the contractual cash flows, then amortized cost is the most relevant measurement basis and a fair value measurement basis would be irrelevant to the users of the financial statements. Moreover, the changes in fair value would introduce needless volatility into the financial statements that users would find distracting.

Following that principle, amortized cost measurement should be the default accounting in the private company sector for financial instruments that are held for collection and payment in order to provide financial statement users with relevant decision-useful information about those instruments. Thus long-term receivables and payables, mortgages payable, own debt, credit lines linked to assets, non-traded bonds, and other loans receivable and payable should be measured at amortized cost because it is normally management's intent to hold those instruments for collection and payment. In circumstances where other criteria are present, such as instruments that are held for trading purposes, derivatives, or if a measurement attribute mismatch exists, then fair value may be a more relevant and appropriate measurement basis. In those circumstances, a fair value measurement principle may be more reflective of the entity's business strategy (e.g., monetizing fair value fluctuations) and management's intent. Assets held for trading are already stated at fair value in private company financial statements and, as these assets typically have an easily obtainable market value, we have no problem with continuing this treatment.

Requiring fair value measurement for financial instruments held for collection and payment would fail to provide relevant information to private company financial statement users who are mostly concerned with the cash flows of these companies. Non-financial institution private companies have many types of financial instruments that would be affected by this proposal. We have attached a chart of these showing how the proposed standard would affect them. Most of these would require a level 3 valuation which would be costly to private company preparers as well as being costly to audit. Estimating fair values for such financial instruments could involve significant judgment and involve the use of extensive modeling and unobservable inputs.

Given the above observations, the PCFRC does not see any compelling reason to significantly alter the accounting for financial instruments in the private company sector by introducing fair value measurements as presented in the proposed ASU. As stated above, these recommendations pertain only to private companies that are not financial institutions as we do not have the expertise on the PCFRC to speak for these entities.

Other Recommendations Should Private Companies Not be Scoped Out

Question 1: Do you agree with the scope of financial instruments included in this proposed Update?

Cost-basis investments. If the Board continues to require fair value for all financial instruments, the PCFRC recommends that an exception (similar to the exception in FIN 46R) be granted for cost basis investments. In some cases, companies will not be able to obtain the requisite information to fair value a cost basis investment from management of the cost basis investee. The cost basis investee may have little or no legal obligation to provide such information to its cost basis investors on an ongoing basis. Accordingly, if a company makes a diligent effort to obtain the information needed to make a fair value measurement for a cost basis investment but cannot obtain the requisite information; the company should be permitted to continue to hold the investment at cost (subject to impairment).

Question 4- The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting?

The PCFRC does not understand why this requirement is included in this proposed ASU. If equity method accounting is problematic, we recommend that this be addressed in a separate project. For most private companies, equity method investments are typically made in other private entities. Entrepreneurial owners of private companies frequently make investments in start-up entities that may or may not be related to the core business. This is how small start-ups get funded. Requiring these investments to be reported at fair value would be costly because there is no ready market for them and the valuation would require the use of extensive modeling and unobservable inputs. The current required disclosures provide sufficient information to users of private company financial statements.

We have heard the argument stated that "if you own it, you should be able to value it." Most owners of private companies do have an idea of what these investments are worth. However, in order to report these at fair value, a formal valuation needs to be done and the auditors have to audit that value, all of which adds unnecessary cost.

Question 37- Do you believe that the objective of the credit impairment model in the proposed update is clear?

The most common “credit impairment” issue that private companies would deal with is credit impairment of trade accounts receivable. Private companies typically provide an allowance for doubtful accounts against trade receivables. Furthermore, the proposed revenue recognition standard proposes changes in accounting for credit impairment that would arise from credit sales. The PCFRC is unclear how the allowance for doubtful accounts under the proposed ASU is utilized under and interacts with the proposed credit impairment model and whether this is different from what is proposed in the revenue recognition ED.

Question 56 Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate?

Question 60-Do you believe that the proposed changes to the hedge accounting model will provide more transparent and consistent information about hedging activities?

Some members of the PCFRC disagree with the FASB’s proposed elimination of the shortcut method related to hedge effectiveness and recommends that it be maintained for private companies. They believe that elimination of the shortcut method will result in increased audit fees with little perceived benefit.

Other PCFRC members are not that concerned with the elimination of the short-cut method. Because the qualitative approach is required and only a reasonably effective threshold needs to be met, they believe a permutation of the short-cut method will survive. However it will not be the same prescriptive method that is used today.

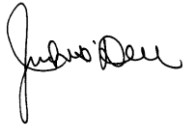
Furthermore, the PCFRC recommends that the final standard contain an example of accounting for a plain- vanilla interest rate swap which is the most common derivative in the private company world.

Question 69: Do you agree with the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1billion in consolidated assets?

If nonpublic, non financial institution entities are not scoped out of this proposed ASU, the PCFRC believes there should be a 4 year delay in implementing **all** provisions of this proposed ASU for these entities.

The PCFRC appreciates the FASB's consideration of these recommendations. Please feel free to contact me if you have any questions or comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Judith H. O'Dell". The signature is fluid and cursive, with a prominent loop at the end.

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

Common Financial Instruments Employed at Private Companies and the Related Accounting

Financial Instrument	FASB's Proposed Accounting	PCFRC Recommendation
Certificates of deposit, money market accounts, and cash equivalents	Fair value with changes recognized in net income or, if requirements met, OCI. Money market accounts would most likely be equity investments and therefore would not qualify for FV-OCI.	Cost basis as these are easily liquidated
Trade accounts receivable and payable – less than 1 year	Amortized cost (net of allowance for doubtful accounts for accounts receivable) Trade receivables must be evaluated for credit impairment which is recognized in net income	Agree with proposed accounting except for requirement to subject trade receivables to further evaluation for credit impairment. In most cases the allowance for doubtful accounts would seem to take into consideration credit impairment but the allowance for doubtful accounts is recorded as bad debt expense in net income. The PCFRC is unclear how the allowance for doubtful accounts under the proposed ASU is utilized under and interacts with the proposed credit impairment model and whether this is different from what is proposed in the revenue recognition ED.
Accounts Receivable and Payable – long term	Fair value with changes recognized in net income or, if requirements met, OCI. Payables may qualify for amortized cost accounting if criteria are met.	Long-term receivables and payables are common at private companies (e.g., software, construction, and furniture industries). PCFRC does not agree with fair value accounting for receivables and recommends amortized cost accounting for receivables and payables held for collection and payment.
Marketable equity securities	Fair value with changes recognized in net income	Agree with proposed accounting
Mortgage payable	In many cases, amortized cost if criteria are met.	PCFRC suggests amortized cost accounting.
Interest rate swaps	Fair value with changes recognized in net income	Agree with proposed accounting
Commodity swaps	Fair value with changes recognized in net income	Agree with proposed accounting

Own debt (For many private companies this would be lines of credit and equipment loans secured by inventory, equipment, etc.)	In many cases, amortized cost if criteria are met.	PCFRC recommends amortized cost accounting. No fair value disclosures needed.
Cost-basis investments	Fair value with changes recognized in net income. Some debt instruments could qualify for FV-OCI accounting.	PCFRC recommends amortized cost.
Equity-method investments	FASB's proposed model narrows the scope of equity method accounting. Those investments now outside the scope will be accounted for at fair value with changes recognized in net income.	PCFRC recommends that this be addressed in a separate project. Requiring these investments to be reported at fair value would be costly because there is no ready market for them and the valuation would require the use of extensive modeling and unobservable inputs. The current required disclosures provide sufficient information to users of private company financial statements.
Credit lines linked to assets	(Scoped out of proposed standard from borrower's perspective.) Amortized cost.	Agree with proposed accounting
Other loans receivable and payable	Fair value with changes recognized in either net income or OCI. Payable may qualify for amortized cost accounting if criteria are met.	PCFRC recommends amortized cost accounting.
Non-traded bonds	Depends upon the instrument. Financial assets – fair value accounting with changes recognized in net income or, if requirements met, OCI. Financial liabilities – accounting could be FV-NI, FV-OCI, or amortized cost.	PCFRC recommends amortized cost accounting.