

# Board Meeting Handout Definition of a Nonpublic Entity October 30, 2013

#### **PURPOSE OF THIS MEETING**

1. On August 7, 2013, the Financial Accounting Standards Board (FASB) issued a proposed Accounting Standards Update, *Definition of a Public Business Entity: An Amendment to the Master Glossary* (proposed Update). The purpose of this meeting is to discuss (a) a summary of the outreach activities undertaken and comments received in response to the proposed Update and (b) the staff's analysis and recommendations for the primary issues identified as a result of the feedback received.

#### **COMMENT LETTER RESPONSES BY CATEGORY**

2. At the time this handout was prepared, 44 comment letters had been received on the proposed Update. Respondents included:

Constituency Type	<b>Constituency Count</b>
Credit Unions and Associations	20
Practitioners	9
State Societies	5
Professional/Industry Associations	5
Preparers	4
Individuals	1
Grand Total	44

#### **OUTREACH AND FEEDBACK**

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

- 3. In addition to the outreach performed during deliberations on the definition of a public business entity (PBE), the staff has obtained feedback through the following channels:
  - a. Comment letters on the proposed Update
  - Comment letters on the following proposed Accounting Standards
     Updates issued on July 1, 2013:
    - (i) Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (13-01A),
    - (ii) *Intangibles—Goodwill and Other (Topic 450), Accounting* for Goodwill (13-01B), and
    - (iii) Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps (13-03)
  - c. Outreach and educational activities including calls and webcasts
  - d. Meetings with advisory groups and regulators including the (i) Not-for-Profit Advisory Committee (NAC), (ii) SEC, (iii) federal financial institution regulators, (iv) Private Company Council (PCC), and (vi) Small Business Advisory Committee.
  - e. Conferences and meetings held by state CPA societies, industry groups, trade associations, and others.

# RESPONSES TO QUESTION 2: DO YOU AGREE WITH THE DEFINITION OF A PBE INCLUDED IN THE PROPOSED UPDATE?

#### Overall Feedback

4. The majority of respondents are supportive of the development of a single definition of a PBE that would be used (a) to amend the master glossary of the FASB Accounting Standards Codification to include one definition of a PBE for use in U.S. GAAP and would be used to specify the scope of future accounting and reporting guidance and (b) to identify the types of business entities that would

- be excluded from the scope of the Private Company Decision-Making Framework (the Guide).
- 5. Respondents generally agreed with many of the proposed criteria included in the proposed definition of a PBE. However, while some respondents indicated general support for the tentative decisions, those respondents disagreed or expressed concerns about aspects of the proposed definition (for example, criterion (e) and the definition of unrestricted securities). Specific concerns are discussed throughout this handout.
- 6. Some respondents suggested that the final definition of a PBE provide implementation guidance that would include examples of entities that would be or would not be considered a PBE. Some stakeholders were concerned that the proposed definition of a PBE would result in more entities being considered public entities than under definitions that currently exist in the Codification. Ernst & Young, LLP (CL#27) stated the following:

Consequently, the benefits of reducing the overall cost and complexity of accounting and financial reporting for nonpublic entities by applying alternatives provided by the PCC and the FASB for those entities would reach a much smaller group of entities than might be anticipated by some constituents.

- 7. A few respondents disagreed with the tentative decisions reached by the Board. Some of those respondents indicated support for a principles-based definition and others suggested that the definition should not be tied to regulatory requirements. Other respondents suggested that the FASB limit the definition of a PBE to an entity that registers with and is subject to the periodic filing requirements of the SEC.
- 8. Some respondents encouraged the Board and staff to continue to collaborate with the SEC staff to ensure that unintended consequences are assessed in circumstances where U.S. GAAP and SEC reporting requirements intersect.

#### Criteria (a), (b), and (c)

9. Some respondents indicated concerns about criteria (a) through (c) of the proposed Update and about linking the definition of a PBE to regulatory requirements.

#### Criterion (a)

10. A primary concern among stakeholders relates to criterion (a). Specifically the portion that indicates that "other entities whose financial statements or financial information are required to be or are included in a filing," would be considered a PBE if that information is submitted in a filing by an entity that files or furnishes financial statements with the SEC. Those respondents indicated that it is unclear whether these entities would be permitted to apply accounting alternatives for private companies in their stand-alone financial statements because their financial statements or financial information may be submitted in a filing with the SEC. BDO (CL#19) stated the following:

If the Board views all equity method investees of an SEC registrant similar to a consolidated subsidiary of a public entity (in that it can report private company GAAP on a stand-alone basis, but must retroactively apply public company U.S. GAAP for purposes of the parent/investor), we recommend clarifying this point within the definition. As the reporting requirements for an equity method investee can vary each reporting period depending on its significance, i.e., investment and income/loss relative to the SEC registrant, it may be difficult to continually reassess and apply the appropriate GAAP.

11. Some stakeholders indicated that there may be unintended consequences related to this criterion. For example, the SEC currently grants disclosure relief to significant equity method investees that are private companies (for example, segment disclosures). These entities would be deemed PBE's under the proposal and as a result, public company disclosures would be required which could be more onerous than existing GAAP. Some stakeholders expressed agreement with criterion (a), however, they suggested that the Board consider when exceptions can be made.

#### Nonissuers

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<sup>&</sup>lt;sup>1</sup> Examples include financial statements of businesses acquired or to be acquired filed in accordance with Rule 3-05 of Regulation S-X; and separate financial statements of investees not consolidated and 50 percent or less owned persons under Rule 3-09 of Regulation S-X.

12. Some stakeholders indicated concerns about nonissuers that are required to file or furnish financial statements with the SEC (for example, Broker-Dealers and Certain Registered Investment Advisors). These respondents suggested that the definition of a PBE should be limited to "issuers" that file or furnish financial statements with the SEC. This alternative would enable nonissuer Broker-Dealers to not have to be considered public because their full set of U.S. GAAP financial statements are not made publicly available (a statement of financial position is filed with the SEC, but the remaining financial statements are confidential and not available to the public).

#### Criterion (d)

13. Overall, most respondents agreed with criterion (d). Some respondents indicated that the phrase "or can be traded" is too broad. Respondents suggested clarification of the Board's intention because there is a difference between entities that choose to have their securities traded or entities that don't but can subsequently decide to have their securities trade on an OTC market. The Financial Reporting Executive Committee (FinREC) of the American Institute of Certified Public Accountants (AICPA) (CL#43) noted the following:

It would be helpful to clarify the term "can be traded." It is unclear whether this means the stock is listed on some exchange and could be traded but perhaps it is not traded or whether this means an entity has the ability to list its shares on some exchange which would enable shares to be traded.

14. Other respondents suggested that the term "unrestricted" be deleted because it's not necessary and creates confusion. A few respondents requested clarification about what constitutes an OTC market and whether an OTC market includes pink sheets. These respondents suggested that if this criterion is retained, an evaluation should be performed based on a qualitative intent based assessment rather than whether the securities are traded. For example, whether an entity is proactively choosing to list on an OTC market, broadly making audited financial statements available to the public, or other factors such as the volume of shares bought or

- sold. A few respondents indicated that criterion (d) should only include a regulated marketplace for issuers that are registered with the SEC.
- 15. The majority of respondents are supportive of the Board's tentative decision reached about conduit bond obligors. One respondent suggested that the definition of a PBE should be based on entities that are indirectly required to comply with SEC Rule 15c2-12, Municipal Securities Disclosure. One member of the PCC suggested that the Board should carefully consider conduit bond obligors and whether to extend accounting alternatives to conduit bond obligors that meet criterion (d) on a standard by standard basis.

### **RESPONSES TO QUESTION 3: CRITERION (E)**

- Question 3: Do you agree that a business entity that has securities that are unrestricted and that is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement should be considered a public business entity? Please explain why. Can you identify a situation in which an entity would meet this criterion but would not meet any of the other criteria identified in the definition of a public business entity? In addition to what is discussed in paragraph BC18 of this proposed Update, do you think further clarification is needed to determine what an unrestricted security is?
- 16. Some respondents agreed with criterion (e) because they indicated that the public availability of financial statements increases the level of access to information that a user would have which is comparable to publicly traded companies that file financial statements with the SEC. However, many respondents indicated concerns about criterion (e) and stated that it is broad which may result in unintended consequences. Some respondents noted that they do not understand the Board's intent in creating this criterion and recommended that this criterion be eliminated from the definition. These respondents also requested clarification about whether an entity would be required to meet all of the conditions included in criterion (e) to be considered a PBE. Some respondents agreed with the fundamental principle, however, they were unable to identify any current circumstances that would result in a company meeting criterion (e) but not any of the other criteria.
- 17. Many respondents recommend clarification on a number of aspects including:

- a. Legal and regulatory reporting requirements
- b. Publicly available on a periodic basis
- Unrestricted securities.

#### Legal or Regulatory Reporting Requirements

- 18. Some respondents suggested clarifying the Board's intent about legal or regulatory requirements. Regulators have varying degrees of focus and, therefore, have different requirements about providing U.S. GAAP financial statements. Examples of entities that could meet this criterion as noted by respondents could include state regulatory or legal reporting requirements for entities such as financial institutions, franchisors, and certain utility companies in states which require entities to file their audited financial statements.
- 19. Some stakeholders indicated concerns that the quarterly submission of financial institution call reports for privately held community banks would meet the definition of U.S. GAAP financial statements, even though the submission does not constitute a full set of financial statements. These respondents recommended that the Board either remove or amend criterion (e) to alleviate any concerns. The Independent Community Bankers Association (ICBA) (CL#8) stated the following:

This criterion could be problematic and could potentially be erroneously adopted in practice....Therefore, we request that the FASB either remove the applicable provision from the proposed ASU when finalized or state specifically that the required submission of selected financial data to a prudential regulator by a financial institution would not qualify the entity as a PBE.

20. Some stakeholders indicated concerns that some regulatory requirements including state regulatory and legal reporting requirements could scope entities into the definition of a PBE. For example, banks with over \$500m in assets are required to file their annual audited financial statements with the FDIC. Furthermore, many other entities may be subject to a filing requirement with regulatory agencies or other legal reporting requirements.

#### Publicly Available on a Periodic Basis

21. Some respondents suggested that the Board clarify what is meant by "publicly available" and "periodic basis." BDO, (CL#19) included the following remarks:

For example, does "publicly available" include financial statements that are available on request, e.g. from a state franchise regulator, or only those published to a wide audience, e.g. on a website? Similarly, does "periodic" mean anything more than once....or is it intended to encompass quarterly and annual financial statement requirements?

#### **Unrestricted securities**

- 22. Paragraph B18 of the proposed Update states, "The Board decided that the definition of a PBE should include only unrestricted securities because many private companies place restrictions on the sale of their securities in a secondary market and can control to whom they sell their securities. Unrestricted securities can be resold to the public without the company's control and generally have an active market, while restricted securities are generally sold to a limited number and type of investors who often will have a greater ability to access management."
- 23. Some stakeholders commented that the term "unrestricted security" should be better defined or described and indicated that paragraph B18 of the proposed Update should be clarified. Some respondents recommended that a different term be used in describing the criteria (for example, unlimited) because the term "unrestricted" is a common term used in legal definitions which could create confusion and different interpretations. For example, some securities can be sold to a limited number of investors and others can be resold to an unlimited number of investors. Some securities might be restricted to only accredited investors. Grant Thorton (CL11) stated:

We believe explicit clarification of what is an "unrestricted security" should be provided in the proposed definition. We note that paragraphs BC15 and BC18 add context for the direction being taken, and we are concerned that it is not sufficiently clear what types of restrictions the Board intends to distinguish unrestricted from restricted.

#### **RESPONSES TO QUESTION 4: NOT-FOR-PROFIT ENTITIES**

**Question 4:** Do you agree that no public or nonpublic distinction should be made between NFPs for financial reporting purposes? Instead, the Board would consider whether all, none, or only some NFPs should be permitted to apply accounting and reporting alternatives within U.S. GAAP. Please explain why.

- 24. Nearly all respondents agreed with the proposed Update that no public or nonpublic distinction should be made between NFPs for financial reporting purposes. Instead, the Board would consider whether all, none, or some NFPs should be permitted to apply accounting and reporting alternatives within U.S. GAAP. Respondents stated that this approach will provide NFPs ample consideration during the research and deliberation phases needed for standard setting.
- 25. Overall, the NAC members agreed with the proposed Update and the Board's decision to not make a bright line distinction between NFPs for purposes of defining a nonpublic or public NFP. A few respondents and NAC members suggested that NFPs that meet the criteria included in the proposed definition of a PBE should be treated similar to those entities. A few respondents indicated that the Board should study differentiation among NFPs with the objective of developing differential factors other than those between public and private companies.
- 26. Some credit unions indicated that the proposed Update was not clear on whether credit unions would be considered NFPs. However, they agreed that a credit union should not be defined as a PBE.

#### **Ouestion 1 for the Board**

Does the Board agree with the staff's recommended changes to the proposed Update including the proposed definition of a Public Business Entity and basis for conclusions?

#### **CONSEQUENTIAL AMENDMENTS**

**Question 5:** Should the Board consider whether to undertake a second phase of the project at a later stage to examine whether to amend existing U.S. GAAP with a new definition resulting from this proposed Update? In that second phase of the project, the Board would consider whether to (a) preserve the original scope of guidance in the Accounting Standards Codification or (b) change the scope of guidance in the Accounting Standards Codification to align with the new definition. Please explain why.

- 27. Of the respondents that commented on this question, most indicated that a second phase of the project should be undertaken to address the current inconsistencies and complexities of having multiple definitions of a nonpublic entity<sup>2</sup> and public entity in the Codification. Some respondents acknowledged that a second phase may delay the final definition of a PBE, however, suggested that the Board undertake the second phase concurrently with the proposed Update, and not at a later stage. Others stated that it is important to finalize the scope of the Guide on a timely basis because of the PCC proposals and that undertaking a second phase at this time would be premature.
- 28. Some of these respondents suggested that the scope of existing guidance should be changed to reflect the new definition. Others indicated that the Board should preserve the originally intended scope of the guidance in the Codification and recommended that the Board have sufficient justification for any change in scope of existing guidance, as determined on a case by case basis.
- 29. The staff has identified the following two alternatives for the Board's consideration.
  - a. **Alternative 1:** Amend the existing definitions of a nonpublic entity in a separate phase of the project to commence following the completion of the definition of a PBE.
  - b. **Alternative 2:** Defer a decision about whether to amend the existing definitions of a nonpublic entity at a later date after additional accounting

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<sup>&</sup>lt;sup>2</sup> For purposes of this handout, the terms *nonpublic entity* and *public entity* are used as antonyms. A nonpublic entity is any entity that is not a public entity.

alternatives are provided for private companies and the Board has an opportunity to learn about any potential implementation issues with the final definition of a PBE.

#### **Question 2 for the Board**

Does the Board agree to: (a) reaffirm its decision reached in the proposed Update that the existing definitions of a nonpublic entity and public entity should not be amended at this time and should remain in the Codification (a new definition of a PBE would be added to the master glossary for use on future guidance) and (b) defer the decision about whether to amend the existing definitions of a nonpublic entity in the Codification at a later stage considering the overall agenda prioritization effort underway?

#### **NEXT STEPS**

#### Exposure Draft, Timeline, and Effective Date

30. The proposed Update indicates that the definition of a PBE would not be finalized until the new term is used in an amendment to a Topic in the Codification.

Therefore, the effective date of the final definition of a PBE would be established concurrently with the first Update that uses the definition of a PBE.

## Question 3 for the Board

Does the Board wish to (a) proceed to the final ASU about the definition of a PBE; and (b) reaffirm that the effective date of the final definition of a PBE would be established concurrently with the first Update that uses the definition of a PBE?