September 18, 2013

Technical Director
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File Reference No. 2013-310

Re: Proposed Accounting Standards Update: Definition of a Public Business Entity – An Amendment to the Master Glossary

The Accounting Principles and Auditing Standards Committee of the California Society of CPAs is pleased to respond to the August 7, 2013 Proposed Accounting Standards Update Definition of a Public Business Entity – An Amendment to the Master Glossary on behalf of the Society.

The Committee agrees that the Board needs to define the distinction between a public and nonpublic (private) business entity in order to set the scope of entities for which the Private Company Council would consider potential accounting and reporting alternatives within U.S. GAAP. But the Committee has two essential disagreements with the approach the Board and the PCC is using to set those alternatives: one with the definition of public vs. private entities, one with how those alternatives may be implemented.

- The Committee believes any entity with a public accountability should be considered to be a public business entity. This would include entities which accept deposits from the public (e.g., banks, credit unions, and trust companies) or are the beneficiaries of government sponsored insurance programs, and insurance companies that offer insurance products to the public, as well as securities brokers/dealers, mutual funds and investment banks. We realize that the Board has to date failed to embrace the reference to public accountability; we see little merit in the Board's rejection of the arguments in paragraphs BCn through BC25. We believe this failure overlooks a significant concern of users. The fact that many of these entities have regulatory requirements to file financial statements, whether or not on a GAAP basis, is evidence that the government, as representative of the people, views public accountability as an important consideration, and it is incongruous not to hold these entities to the higher standard of non-alternative GAAP financial statements.

- The Board is issuing accounting and reporting alternatives for private companies on a piecemeal basis and including them within its single set of U.S. GAAP guidance. The Committee believes that alternatives for private companies should be provided as a separate comprehensive framework. Further, those entities which adopt those standards should adopt all of them. Piecemeal adoption will tend to undermine the credibility of the standards and confuse users as to what accounting and disclosure policies are being used, no matter how much explanation is provided as to what standards are used.
Question 1: Please describe the entity or individual responding to this request. For example:
   a. Please indicate whether you primarily are a preparer, user, or public accountant. If other, please specify.
   b. If you are a preparer of financial statements, please indicate whether your entity today is considered privately held or publicly held and describe your primary business and its size (in terms of annual revenue, the number of employees, or other relevant metric).
   c. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on public entities, private entities, or both.
   d. If you are a user of financial statements, please indicate in what capacity (for example, lender, investor, analyst, or rating agency) and whether you primarily use financial statements of private entities or those of both private entities and public entities.

The Accounting Principles and Auditing Standards Committee ("Committee") of the California Society of Certified Public Accountants ("CalCPA") is the senior technical committee of CalCPA. CalCPA has approximately 40,000 members. The Committee includes 53 members, of whom 47 percent are from local or regional firms, 27 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 10 percent are in academia and 4 percent are in international firms. Members of the Committee are with firms which serve a large number of public and nonpublic business entities, as well as many nonbusiness entities such as NFPs, pension plans, and governmental organizations.

Question 2: Do you agree with the definition of a public business entity included in this proposed Update? Please explain why.

We agree with the essence of the proposed definition of a public business entity, except as described below.

We believe the following should be clarified:

- Criterion 1 in the definition of a public entity states:

  1. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements, with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).

The intent of the parenthetical phrase starting in the second line is unclear, and we suggest that the criterion be simplified to delete the parenthetical phrase. That would make it clear that it applies to registrants, nonregistrants who file or are required to file with the SEC, and entities filing with the SEC for a public offering, but not other entities whose financial data is included in a filing; the financial statements of those latter entities which are included in a filing would, of course, need to comply with SEC requirements in the SEC filing, but they would clearly not be public companies. There are problems with the parenthetical if it is retained:

- The phrase “other entities whose financial statements or financial information are required to be or are included in a filing (with the SEC),” would cause such entities to be included in the definition of public business entities. This literally includes any entity whose financial statements are included or required to be included in a filing, including unconsolidated subsidiaries, nonconsolidated investees who
are not SEC registrants, and other entities which are not SEC registrants. We do not believe they should be considered public business entities for financial statements they may prepare for purposes other than SEC filings, unless they are public business entities in their own right. They are in a position very similar to that of consolidated subsidiaries, which are generally not considered public business entities.

- The phrase "entities whose . . . financial information . . . (is) included in a filing" (with the SEC) is part of the definition of an entity meeting the definition of a public business entity. This reference appears to be mainly directed toward financial information included as part of financial statements required by SEC Regulation S-X. However, it would literally include all other financial information in an SEC filing, whether or not it is part of the financial statements, and even if in the financial statements, would not necessarily be sufficiently comprehensive to be considered a financial statement, and thereby cause the entity to which the financial information relates to be considered a public business entity. It could potentially include information of consolidated subsidiaries or of non-consolidated affiliates. This seems far too broad. The criterion should be narrowed to limit the scope of "financial information" to exclude information which is not a complete financial statement (e.g., a summarized financial statement), it is not complying with GAAP requirements, or its presentation is governed only by SEC requirements. Alternatively, it may be possible to delete reference to "financial information" entirely.

- We have concern over the use of the word "unrestricted" in criteria 4 and 5. See our response to Question 3 below.

- Certain employee benefit plans are themselves SEC registrants. Should not the definition be clarified to include them as public entities?

We take exception to the following:

- The criteria 2 and 3 refer to financial statements filed with regulatory agencies, but neither requires that entities required to make routine filings of financial statements with regulatory agencies be considered public business entities. As stated above, we believe any entity with a public accountability, should be considered to be a public business entity.

- As stated above, we believe that alternatives for private companies should be provided as a separate comprehensive framework, and that those entities which adopt those standards should adopt all of them. While we do not object to inclusion of the initial piecemeal standards for private entities within the Board's single set of U.S. GAAP, we believe that as those standards become more comprehensive, they should all be presented in a separate framework.

**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?

We agree with the inclusion of entities in criteria 4 and 5 as public business entities for the reasons set forth on paragraph BC18. However, the term "unrestricted" will create confusion; it is a common term used in legal definitions of the salability of securities with a different meaning that that used by the Board. We recommend a different word be used in describing the criteria, such as "unlimited." We further recommend that, whatever term is used, that it be defined as part of the criteria. It is too important to be lost in the basis for conclusions.

The distinction between restricted and unrestricted securities is unclear. The control over sale of securities by many private companies seems clear enough. However, there is a broad spectrum of potential distribution once that control is not in effect, and the securities have become "unrestricted." Sale to a limited number of investors is toward one end of the spectrum (i.e., if there is no limit on salability) and resale to the public (but not sufficient to require SEC registration) approaches the other end of the spectrum, but they are all "unrestricted" regardless of ability to access management. Criterion 4 has a limiting condition of "can be traded on . . . an over-the-counter market"; while it is a legal determination as to what securities can be traded in an over-the-counter market, for many small entities, it may be a matter of choice, where they can have their securities traded in an OTC market if they choose to. It is important that the Board study and clarify the distinction, since if it is left as ambiguous as it is in the proposal, interpretation could be very inconsistent. We suggest that the reference to "unrestricted" in Criterion 4 be deleted, and the criterion reworded to apply to "securities that are traded or listed for trading on an exchange or an over-the-counter market."

**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.

The Board has excluded NFPs from the definition of a public business entity, and the Committee does not take exception to this at this time except for the exclusion of NFPs which are conduit entities for public securities (see comment below).

However, the Committee believes the Board should study differentiation among NFPs with the objective of providing certain NFPs with an alternative GAAP. For example, many NFPs have regulatory filing requirements, but many do not. Some solicit support broadly; others do not. In many larger NFPs, access by supporters to management as a practical matter is not feasible. Alternative GAAP for certain NFPs needs further study, and may involve differential factors other than those between public and private companies. But, without identification of differential factors for NFPs, we do not believe the standard-by-standard approach the Board plans on using will be workable.

We question the wisdom of excluding NFPs which are conduit entities for public securities (usually debt) from the definition of public business entities. These entities have sufficient similarity to other entities considered "public" in the proposed ASU
that they should be included as public. The statement in paragraph BC34 hardly provides any explanation for the Board's basis for its position.

**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.

The Committee believes it is unfortunate that the Board does not plan to complete the "second phase" before finalizing this proposed ASU. There is always the danger that unexpected difficulties could arise when the current guidance is compared with that in the proposed ASU. Moreover, if changes would affect mostly disclosures, as the Board asserts in paragraph BC37, amendments should be relatively straightforward.

So, the Board should undertake this second phase as soon as practicable. Having a new definition of a public entity while trying to maintain the existing definition will inevitably exacerbate the confusion currently encountered with the multiple definitions.

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We would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

Michael Feinstein, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants