



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

2013-310
Comment Letter No. 27

Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

20 September 2013

Re: Proposed Accounting Standards Update, *Definition of a Public Business Entity* (File Reference No. 2013-310)

Dear Ms. Cospers:

As the auditor of more than 3,000 private entities, we appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Definition of a Public Business Entity* (the proposed Update).

We support the development of a single definition of a public business entity (PBE) that the Financial Accounting Standards Board (FASB or Board), the Private Company Council (PCC) and the Emerging Issues Task Force (EITF) would use in setting the scope of future standards. We also support using this definition to determine which entities would be excluded from the scope of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (Guide). However, we believe certain issues need to be addressed before any final guidance on this subject is published.

Our recommendations

We are concerned that the proposed definition of a PBE is complex and would be challenging to apply. We also note that the definition would include many entities that previously have not been treated as public companies and might differ from existing SEC rules, regulations and interpretations, as discussed later in our letter.

Our concerns primarily relate to: (1) the phrase "or financial information" found in criterion a because it draws in entities for which full financial statements might not be required (that is, causes an entity to be a PBE solely because of a disclosure requirement to include less than a full set of financial statements), (2) the requirements that all entities that file or furnish financial statements with a regulatory agency prepare financial statements in accordance with public business entity guidance and (3) criterion e's description of a public business entity as including an entity "whose securities are unrestricted, and it 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" because we don't understand the intent of this criterion. Consequently, we recommend that the proposed definition of a PBE be simplified as follows:

A PBE is a business entity that has an obligation to file financial statements with a securities commission or other regulatory organization for the purpose of selling securities in a public market in primary and secondary offerings or aftermarket trading.

Our definition would include entities that have securities registered under the Securities Act of 1933 or the Securities Exchange Act of 1934. Further, our definition would not include entities that make exempt securities offerings under Regulation A (or under the so-called Regulation A+ or crowdfunding exemption to be adopted under the Jumpstart Our Business Startups Act [JOBS Act]).

We believe all other entities should be considered nonpublic entities. We support the Board's proposal to consider not-for-profit entities (NFPs) and employee benefit plans (EBPs) separately. Therefore, we believe the population of nonpublic entities should include nonpublic business entities (NPBEs), NFPs and EBPs.

We recommend that the Board define an NPBE for use when deciding which entities should be afforded accommodations made for private companies as follows:

"An NPBE is a business entity that is not a PBE, NFP or EBP."

We recommend that the Boards define PBEs and NPBEs concurrently and explicitly (that is, do not make constituents determine what an NPBE is by deductive analysis).

Our recommendation is intended to:

- ▶ Provide explicit definitions for business entities using US GAAP
- ▶ Exclude from the definition of a PBE the following entities:
 - ▶ Subsidiaries of PBEs and investees of PBEs
 - ▶ Parents of PBEs
 - ▶ Entities whose financial statements are filed with or furnished to a regulatory agency for purposes of satisfying the requirements of another entity (for example, pursuant to SEC Rules 3-05, 3-09, 3-14 or 3-16 of Regulation S-X)
 - ▶ Entities whose financial statements are filed with or furnished to a regulatory agency for purposes of satisfying the requirements unrelated to offering and listing of securities
 - ▶ Entities that engage in exempt offerings of securities that do not trigger a filing requirement
 - ▶ Entities whose financial statements might be required to be posted to an entity's website pursuant to a contract with a bank or another entity
 - ▶ Entities whose financial statements might become publicly available under the Freedom of Information Act or because of a contractual arrangement

Questions to be addressed by the Board

If the Board decides not to accept all of our recommendations, we believe the Board should address certain questions and possibly modify the proposal to address certain issues we discuss below.

It appears that the five criteria in the proposed definition could result in more entities being considered public entities than under definitions that currently exist in the Accounting Standards Codification. It also appears that some of these entities would continue to be considered nonpublic under existing SEC guidance. 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. Is this what the Board intends?

Furthermore, by sweeping more entities into the definition of a PBE, the proposal could result in an increase in financial reporting requirements, which we did not understand to be the objective of the proposal. This would be the case for entities whose financial statements or financial information must be included in a filing with the SEC. This group includes entities acquired by an SEC reporting company, subsidiaries not consolidated and 50% or less owned persons, real estate operations acquired and affiliates whose securities collateralize an issue registered or being registered. It seems inconsistent that acquirees, investees and affiliates of an SEC reporting company would be PBEs solely because of the obligations of the SEC reporting company.

Considering these entities to be public business entities arguably differs from existing SEC rules and regulations that generally allow for these entities to be considered private entities for the purposes of including their financial statements in SEC filings under Rules 3-05, 3-09, 3-14 and 3-16 of Regulation S-X. We understand the SEC generally has allowed financial statements filed under these rules to be presented in accordance with existing "private company requirements" because (1) the SEC reporting company, not the private entity, is obligated to file the financial statements and (2) it limits the preparatory burden.

We are aware that some constituents question whether the phrase "other financial information" in proposed criterion a would require that information disclosed under Rule 4-08(g) of Regulation S-X be prepared as if the underlying entity were a PBE. Is this the Board's intent?

Proposed criterion e provides the following definition of a public entity:

"Its securities are unrestricted, and it 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."

This criterion raises a number of questions that we believe the Board should consider before finalizing the definition of a public business entity, including:

- ▶ Would information filed with a regulatory agency such as the Environment Protection Agency that might be retrievable under the Freedom of Information Act meet the criterion of being "made publicly available"?

- ▶ What constitutes “a legal or regulatory requirement”? Would a requirement under a bank loan to make US GAAP financial statements publicly available on a company’s website constitute a legal requirement?
- ▶ How would this criterion be applied to financial institutions including bank and insurance companies that are currently considered to be private entities?
- ▶ Would this criterion include entities that make exempt public offerings of securities under Regulation A (or under the so-called Regulation A+ or crowdfunding exemption to be adopted under the JOBS Act)?

Many financial institutions are required to provide US GAAP financial statements to a regulator on a periodic basis pursuant to a legal or regulatory requirement. The financial information provided might be publicly available on its submission or upon request from the users of financial statements. It appears that many financial institutions could be considered public business entities based on criterion e of the proposed Update. We ask whether that was the intent of the Board when it drafted the proposed definition of a PBE. If this was the Board’s intent, it should be clear. We recommend that the Board consider including a table of common examples and a conclusion on whether the entity is a PBE to help preparers implement the standard and to promote consistent application.

We noted that the Board has issued the proposed Update to identify the types of business entities that would be excluded from the scope of the Guide. The Board and the PCC voted to finalize the Guide in July, and the final Guide is expected to be issued soon. We believe that the definition in the proposed Update should align with the definition included in the Guide before its finalization.

We recommend that the Board launch a second phase of the project to examine whether to amend existing US GAAP with a new definition resulting from the proposed Update and to eliminate conflicting definitions of “nonpublic entity” in the Master Glossary.

We observe that a question that is likely to be raised is how to transition from an NPBE to being a PBE. The Board should consider addressing transition in this or a related project.

We also note that the proposal has raised questions about how the relief afforded to emerging growth companies under the JOBS Act might be affected. We suggest that the Board coordinate with the SEC on this point, if it has not already done so, to avoid any unintended consequences.

In the Appendix to this letter, we provide our responses to the Board’s Questions for Respondents in the Exposure Draft.

* * * * *

We would be pleased to discuss our questions and comments with the Board or the FASB staff at your convenience.

Very truly yours,



Responses to specific questions raised in the Proposed Accounting Standards Update, *Definition of a Public Business Entity*

This Appendix includes our responses to questions addressed to all respondents or specifically to auditors. We have not responded to questions addressed only to preparers or users.

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.

Ernst & Young LLP is one of the largest firms auditing both public and private entities. We currently audit approximately 3,000 private entities, ranging from small start-ups and family-owned enterprises to large privately held multinational corporations.

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

While we support a single definition of a PBE, we are concerned that the proposed definition is complex and would be challenging to apply. We also note the proposed definition would include in its scope many entities that previously have not been treated as public companies and may differ from existing SEC rules, regulations and interpretations.

Our concerns primarily relate to: (1) the phrase “or financial information” found in criterion a because it draws in entities for which full financial statements might not be required (that is, causes an entity to be a PBE solely because of a disclosure requirement to include less than a full set of financial statements), (2) the requirements that all entities that file or furnish financial statements with a regulatory agency prepare financial statements in accordance with public business entity guidance (3) criterion e’s description of a public business entity as including an entity “whose securities are unrestricted, and it 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” because we don’t understand the intent of this criterion.

Refer to the section titled “Our recommendations” for additional discussion and our recommendations.

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 are unable to answer this question because we do not understand the intended scope of this criterion, as mentioned above in the section on "Questions to be addressed by the Board."

Instead, as stated above, we recommend that the definition of a PBE be limited to a business entity that has an obligation to file financial statements with a securities commission or other regulatory organization for the purpose of selling securities in a public market in primary and secondary offerings or aftermarket trading. Such a definition would not include entities with securities that do not have issuer-imposed transfer restrictions unless those entities are required to register those securities.

If the Board retains a criterion that refers to "unrestricted" securities, we believe clarification of paragraph BC18 of the proposed Update would be helpful to determine what an unrestricted security is. BC18 only addresses restrictions imposed by the issuer. SEC Rule 144 is commonly referred to when distinguishing between "restricted" and "unrestricted" securities for purposes of the federal securities laws. The inconsistency between BC18 and application of Rule 144 likely would create confusion in applying the proposed definition. BC18 also states that unrestricted securities of otherwise private companies generally have an active market, which we do not observe to be an accurate assumption.

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.

As discussed in our cover letter, we believe all entities other than PBEs should be considered nonpublic entities. At the same time, we support the Board's proposal to consider not-for-profit entities (NFPs) and employee benefit plans (EBPs) separately. Therefore, we believe the population of nonpublic entities should include NPBEs, NFPs and EBPs.

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.

We recommend that the Board launch a second phase of the project to examine whether to amend existing US GAAP with a new definition resulting from the proposed Update and to eliminate conflicting definitions of "nonpublic entity" in the Master Glossary.