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October 28, 2013

Mr. Russell Golden
Chair
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856
United States

Re: Comment Letter on Definition of a Public Business Entity

Dear Mr. Golden,

CFA Institute,¹ in consultation with its Corporate Disclosure Policy Council (“CDPC”)², appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB” or “Board”) Proposed Accounting Standards Update (“Proposed Update”), *Definition of a Public Business Entity*.

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

¹ With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 121,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 142 countries, of whom more than 113,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

OVERALL COMMENTS

Comparability Essential for Investors

To operate efficiently, capital markets require financial information that is:

- (a) comparable from firm to firm;
- (b) relevant to investment and financing decisions;
- (c) a reliable and faithful depiction of economic reality; and
- (d) neutral.

As a result of these requirements, CFA Institute has a long-standing position that transactions and economic activities that are similar should be reported similarly in financial statements – irrespective of the nature of the underlying ownership structure of the entity engaging in the transaction. For that reason, CFA Institute opposes different reporting standards based on ownership (public, private, nonprofit), size, or industry. Separate private company reporting would reduce comparability between the financial statements of U.S. public and private companies, which is essential to those who invest across both private and public companies. Permitting an alternative accounting regime for private entities hinders investors' financial analysis and the investment decision-making process. Accordingly, we prefer that one set of standards apply to both public and private entities.

Proliferation of Accounting & Disclosure Requirements:

Decreases Comparability & Increases Complexity for Users of Financial Statements

During the last several years there has been a movement in the U.S. toward the creation of separate accounting and disclosure requirements for different types of entities. If adopted, the following differing bases of accounting and disclosures requirements would be applicable in the U.S.:

- *Small to Medium Sized Entities* – AICPA's other comprehensive basis of accounting (OCBOA).
- *Emerging Growth Companies* – Limited disclosures under the Jumpstart Our Business Startups (JOBS) Act.
- *Private Companies* – Private company U.S. generally accepted accounting principles (GAAP).
- *Public Companies* – Compliance with full U.S. GAAP and SEC requirements.

This movement towards the creation of multiple bases of accounting and financial reporting standards is, in our view, antithetical to the pursuit of comparable, relevant and decision-useful financial information for investors and to the pursuit of a single-set of global standards. Our view is that the aforementioned proliferation of accounting and disclosure requirements will compound the comparability issues and increase, rather than reduce, complexity in financial reporting for users.

Private Company Accounting & Resulting Decreased Comparability:***Opens Door to Investor Support for Optional Adoption of IFRS by U.S. Public Companies***

The development of multiple bases of accounting in the U.S. opens the door to investors support for the optional use of International Financial Reporting Standards (IFRS) in the U.S. as their development belies the notion of a single accounting standard within the United States.

Reduction in comparability between the financial statements of U.S. public and private companies is one reason specified by IFRS opponents for not allowing adoption of IFRS by U.S. public companies. Since comparability between U.S. private and public companies will be reduced by separate private company standards, investors – who rely on comparability – are likely to query why optional adoption of IFRS shouldn't be allowed if it improves comparability for large multinationals – with peer companies preparing their financial statements under IFRS. We think this should be a consideration in the dialogue regarding the creation of separate private company accounting.

Optionality Related to Private Company Accounting Rules:***Creates Further Comparability and Complexity Issues for Users of Financial Statements***

The Proposed Update creates further comparability and complexity issues for investors and users by creating varying degrees of optionality. Consider the following:

- *Optional Application on Standard-by-Standard Basis* – The proposed public business entity (PBE) definition, if approved, would be used in the future to provide a starting point for discussions regarding the scope of alternatives developed for private companies. However, the Private Company Council (PCC) and the FASB would still have leeway to determine which private entities use private company standards. Said differently, the FASB would be allowed to pick and choose the entities to which private company guidance would apply.
- *Optional Application to Not-for-Profits and Employee Benefit Plans* – The FASB on a standard-by-standard basis would also determine whether all, none or only some not-for-profit entities (NFPs) and employee benefit plans will be eligible to apply exceptions and alternatives available to nonpublic entities.
- *Allowing Private Companies Optional Adoption* – Finally, private companies would be allowed the choice of applying some but not all of the private company reporting alternatives.

We are concerned that the multiple types of “options” raise questions as to what U.S. GAAP really represents. Standards are by definition meant to be something established by authority, custom, or general consent as a model or example. Optionality belies the notion of creating standards.

Concern: What Is U.S. GAAP?

CFA Institute is concerned that the creation of a private company version of U.S. GAAP compounded by optionality as to when it may be used and by whom (as noted above) raises the question of what constitutes U.S. GAAP. Audit opinions will simply state that the financial statements of private companies have been prepared in accordance with U.S. GAAP and the basis of presentation footnotes are likely to be very generic in their qualitative description of the options taken – without any quantification of the differences. Investors will be left to discern the nature and quantification of the differences. We are also concerned that the optionality and lack

of comparability will lead to the perception that the quality of U.S. GAAP has declined as investors realize that the standards are not, and no longer need be, uniformly applied.

Inconsistent Definitions of Nonpublic and Public Entities Creates Confusion

The Proposed Update notes that stakeholders have inquired “about the inconsistency and complexity of having multiple definitions of a nonpublic entity and public entity within U.S. GAAP.” The Basis for Conclusions states that the Board “acknowledged that eliminating the multiple definitions of a nonpublic entity and public entity in the Accounting Standards Codification (ASC) could reduce confusion among stakeholders and simplify the definition, which could help reduce complexity in financial reporting.”

CFA Institute believes that the FASB needs to resolve the differences between and consolidate all the definitions of a public entity contained within the ASC. Indeed, one reason for codifying U.S. GAAP standards was to remove such inconsistencies. Since the ASC would continue to include numerous definitions of a public entity (and related terms such as “publicly traded company”), complexity and confusion for investors not only remains but also may increase with the inclusion of yet another definition for a PBE. Accordingly, we disagree with the proposal that a new definition of a public business entity should be used to distinguish between different types of entities in future standard setting without resolving the inconsistencies between the existing definitions.

Changes to U.S. GAAP for Public Companies

We understand that the Board may, in the future, evaluate whether a particular private company accounting or reporting alternative be extended to a public business entity. We are concerned by the notion that changes to private company accounting will subsequently be used to alter the accounting and disclosure requirements for public companies when the basis for the change to private company accounting is not grounded in the need to most appropriately reflect the underlying economics of transactions in the financial statements and provide the most decision-useful information to investors.

If standards are to be modified for public and private companies, they should be based upon the need for relevant, decision-useful information for investors and they should be added to the agenda, subjected to the same due process, and provided with the same degree of profile and awareness as other standards. As we describe more fully in the discussion of due process below, investors, in our view, are not sufficiently aware of the FASB’s private company initiative and the implications it will have on private company accounting. We are concerned that the private company initiative will act as a means to initiate backdoor changes to public company accounting.

***Investors Will Need To Price These Differences:
Will That Cost Be Greater Than Cost of Compliance?***

The private company initiative is premised on reducing the cost of compliance for private companies without consideration of the cost to investors and other users of the financial statements. The cost to this latter group of stakeholders will take the form of a higher cost of capital due to the lack of comparability and the perception by investors that private company accounting is of lower quality. With the implementation of the JOBS Act, we have observed that many companies registering under the legislation (e.g. Twitter) do not avail themselves of the ability to provide less information (e.g. two versus three years) than other publicly listed companies must provide. They do not avail themselves of this relief because of the negative perception investors may have of the company, its results or its management if they do. Registrants under the JOBS Act understand investors will price the perceived risk associated with lesser quality accounting and disclosures. The same will be true of users of financial statements prepared under the proposed private company accounting rules.

Investors and users of private company financials will price the lack of comparability, transparency and clarity in private company financial reporting. Companies will incur the cost of not providing the information through a higher cost of capital. Studies have shown that the indirect cost of not providing the information is likely higher than the direct cost of providing the information. Because of this, we urge the Board to be more expansive in its cost-benefit analysis. Investors and users of private company financial statements will lose transparency, clarity, and comparability and will need to price the requisite lack of information created by such guidance. The onus on determining and pricing all the differences will be placed on investors, especially if disclosure of differences is only narrative.

Due Process Concerns: Chronology, Focus & Timing

As we have previously articulated, we believe that the first step in the overall private company project should have been for the FASB to finalize the definition of a public vs. private company. Instead, the Financial Accounting Foundation (FAF) first formed the PCC. The FASB then issued the private company decision-making framework. This was followed by the FASB seeking comment on three alternatives proposed by the PCC (accounting for identifiable intangible assets, goodwill and certain receive-variable, pay-fixed interest rate swaps) and endorsing a fourth alternative related to the consolidation of common control leasing arrangements. The FASB then exposed for comment this Proposed Update, which is meant to define a public business entity.

Deferring the decision of who is to apply such private company standards to the last decision in the process is reverse of what stakeholders would expect. The reversed chronology of events has deferred and reduced focus on the private company initiative. We have observed that the issuance of this Proposed Update has increased awareness amongst the highly engaged stakeholder community of the implications of this initiative. Investors – who are traditionally the least engaged stakeholders in the standard setting process – are virtually unaware of the private company initiative. We believe the reversed chronology of the project's development has contributed to even less investor/user awareness. By not defining whom the private company standards might apply to, engagement by stakeholders has been substantially reduced.

We believe the Board has a responsibility to define the user/investor community who will be affected by these changes, increase their awareness of the initiative, and perform more extensive outreach to gain their insights.

Finally, we are concerned by the timing of the aforementioned initiatives to establish private company reporting. The various standards have had very short due process periods – mostly over the summer months. We believe this has further decreased investor/user awareness and input to the project.

Overall, we believe the Board should evaluate the timing and timetable of these proposals, the degree of awareness of this project amongst the user community and the degree to which they have sought and obtained user input on the proposals.

Few Truly Private Entities: Relief Should Be Provided Only for Small Private Companies

As we noted in our [2012 comment letter](#) to the Financial Accounting Foundation's, *Plan to Establish the Private Company Standards Improvement Council*, it is our view that there are few truly private companies and that it is almost impossible to draw the line between public and private companies as there are many investors in private entities and many users of their financial statements. Our view is that the only truly private companies are those with a single owner-manager and no external financing. A single owner-manager can choose to have financial statements prepared in whatever form he or she finds useful. All other enterprises have either investors or creditors who need financial statements to evaluate their investing or lending decisions.

Private companies differ greatly in size, complexity of activities that they undertake, and the accounting personnel they retain. The Proposed Update states that “the FASB and the PCC aim to achieve an appropriate cost-benefit balance by providing accounting and reporting alternatives to entities that are within the scope of the guide (which is not based on the notion of public accountability).” We disagree with the notion of basing the scope of private company guidance primarily upon compliance costs for private companies. The issue of cost or limited resources does not pertain to large (and sometimes widely held) private companies such as Cargill, Mars Koch Industries. Furthermore, in the case of widely held private companies (and even some closely held private companies), investors do not necessarily have any access to management – a faulty assumption which underlies the private company differential framework – that they might with truly small private companies. As noted in the [2012 Forbes listing of America's largest private companies](#), there are a significant number of private companies with substantial revenues, employees and resources which will be subject to these private company exceptions.

It is our view, that if the FASB and PCC were to consider providing some relief for private companies, such relief should only be considered for private companies that are truly small with limited resources. Further, we believe there is a need for a logical definition of a public entity rather than the current multiple definitions that are in place simply to address the scope issues of individual standards.³

³ The Proposed Update states “different definitions of the terms nonpublic entity and public entity were established to address the scope of an individual standard, differences in accounting or disclosure requirements, and deferred effective dates.”

Public Entities: Proposed Update Creates Complexity & Confusion

While seeking to simplify the accounting and reporting for private companies, the Proposed Update has created potential confusion and complexity for public companies, their investors and the users of their financial statements. The following examples highlight the potential complexity created for public companies as a result of the Proposed Update:

- 1) *Equity Method Investments in Private Companies* – Consider public companies that own an equity method interest in a private company which prepares its financial statements in accordance with private company rules. The private company investee could have financial results that differ substantially in their preparation basis from the preparation basis of the public company investor. Both, however, will be labeled U.S. GAAP. While we recognize that conformity of accounting principles between the investee and investors is not required today (conformity here relates to different acceptable methods under GAAP unlike the case here where private company accounting may not be acceptable public company GAAP), the private company proposals serve to create further unnecessary differences. Investors question why an equity method investee following IFRS would be required to convert to U.S. GAAP when there could be more substantial differences between the U.S. GAAP of public and private companies.
- 2) *Financials to Be Included in Filings of Public Companies* – Per the proposed PBE definition, an entity that might not otherwise meet the definition of a PBE could become a PBE if its financial statements are to be included in another entity’s SEC filing. This could be the case for purposes of disclosing a significant equity method investment under Regulation S-X, Rule 3-09 or a significant acquisition under Regulation S-X, Rule 3-05. Such an entity may have to eliminate any previously elected private company accounting alternatives from its historical financial statements before including them in the acquiring entity’s SEC filing.
- 3) *Subsidiaries of Public Companies* – Under the proposed definition, a subsidiary of a public entity would not be considered a PBE for purposes of its standalone financial statements unless those financial statements are included in an SEC filing by the parent company. A subsidiary, however, is considered a public entity under some current U.S. GAAP definitions. This raises a number of concerns including:
 - The Proposed Update does not elaborate on how a subsidiary that is a nonpublic entity under the PBE definition but is public entity under a previous definition is meant to deal with the inconsistencies in definition.
 - The existence of potentially conflicting accounting information (where the financial statements of a private subsidiary may not reconcile to information about the subsidiary included in the consolidated financial statements of the public company parent) may cause confusion for investors.Further, the use of private company accounting by a private subsidiary whose operations are a substantial portion of the public company’s financial results does not seem appropriate.
- 4) *Private Company that Controls a Public Subsidiary* – Under the proposed definition, a private company that controls a public subsidiary would be allowed to apply accounting and reporting alternatives for private companies. Some have raised the question of whether this is appropriate when that controlling private company has a significant number of public

- subsidiaries or when its primary operations consist of holding an investment in one or more public subsidiaries. Further, the cost savings in such a case would not be substantial.
- 5) *Private Companies That Subsequently Access Capital Markets* – Further, qualifying nonpublic entities that are considering accessing the public markets in the future would have to consider whether or not to adopt the private company accounting and reporting alternatives available to them. Upon a decision to become a public company the question becomes: would a private company that previously elected PCC alternatives need to retrospectively apply the accounting and reporting requirements for PBEs in all historical financial statements presented in a registration statement filed with the SEC? Some have suggested that private companies previously availing themselves of the private company exceptions should be granted an exception from this retrospective application when becoming public companies. We do not agree with such proposals. The SEC and FASB, therefore, need to clarify transition guidance for when an entity becomes, or is no longer, a PBE.

Thank you again for the opportunity to comment on the FASB Proposed Update. If you or your staff have questions or seek further elaboration of our views, please contact either Mohini Singh, ACA, by phone at +1.434.951.4882, or by e-mail at mohini.singh@cfainstitute.org or Sandra J. Peters, CPA, CFA by phone at +1.212.754.8350 or by email at sandra.peters@cfainstitute.org.

Sincerely,

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/s/ Ashwinpaul C. Sondhi
Ashwinpaul C. Sondhi
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