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Public Business Entity: Clarifying Key Terms for NFPs

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Conduit Debt Obligations: Is Your Not-for-Profit Scoped In or Out of Accelerated Effective Dates? ***Clarification of Key Terms in the Definition of "Public Business Entity"***

Not-for-profit entities (NFPs) with conduit bonds that meet certain characteristics are subject to the same effective dates and expanded disclosure requirements that certain FASB standards impose on public business entities. However, careful attention should be paid to FASB's terminology, as not all conduit bonds fit the characteristics that subject NFPs to these requirements. This article discusses the information available to help NFPs determine whether they are subject to the requirements of "public business entities" (PBEs).

Background

In 2013, FASB amended the Master Glossary of the FASB *Accounting Standards Codification*® to include one definition of PBE for future use in accounting standards. Not-for-profit entities (NFPs) are specifically scoped out of the definition of PBE in the Master Glossary. However, certain NFPs are subject to the same requirements imposed on PBEs by certain FASB standards. In addition, these NFPs are differentiated using terms similar to those used in criterion (d) of the definition of a PBE[1].

Several FASB standards subject an NFP that has "issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter [OTC] market" to the same accelerated effective dates and expanded disclosure requirements imposed on PBEs. This includes the new revenue[2] and leases[3] standards. The proposed ASU on contributions received and made[4] also includes a similar differentiation in its proposed effective dates. Similar terminology is also used in the multiple Master Glossary definitions of "public entity," which FASB used to differentiate effective dates and disclosure requirements in certain standards issued prior to the use of the PBE definition. For example, certain pension disclosures are required for NFPs only if the NFP is deemed to be a public entity.

AICPA TQAs clarify terms in the definition of 'public business entity'

As a practical matter, understanding the key terms is important for NFPs to determine whether they may take advantage of the delayed effective dates and scaled disclosures available to NFPs that are not considered "public." Therefore, the AICPA recently issued several Technical Questions and Answers (http://www.aicpa.org/InterestAreas/FRC/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx) (TQAs), which clarified certain terms included in the definition of "public business entity."

The TQAs were specifically intended to address questions regarding the definition of a PBE and were therefore not intended to serve as guidance to NFPs. However, some of the TQAs may assist NFPs in understanding the key terms FASB uses to differentiate NFPs. We summarize the most relevant of the TQAs below and provide a summary of the guidance available to NFPs in the AICPA Audit and Accounting Guides.

Guidance available to NFPs

The AICPA Audit and Accounting Guide, *Not-for-Profit Entities* (NFP Audit Guide) and the AICPA Audit and Accounting Guide, *Health Care Entities* (Health Care Audit Guide) (collectively, the Audit Guides), provide guidance relative to the determination as to whether conduit bonds trade in public markets. The guidance provided in each of these audit guides relative to consideration of public markets is consistent.

Specifically, paragraph 10.19 in the NFP Audit Guide states:

"The FASB ASC glossary has multiple definitions for the term *public entity*. Generally, these are entities that have debt or equity securities that trade in public markets. When applying accounting standards that refer to public entities, careful attention should be paid to the requirements to determine which definition applies and whether the definition includes conduit bond obligors within its scope. If within its scope, it is also necessary to determine whether the obligor's securities trade in public markets (for example, over-the-counter markets). As discussed in paragraph 10.24, if conduit bonds have been issued on behalf of an NFP in a competitive or negotiated offering, they are deemed to trade in public markets; bonds issued in a private placement would not be deemed to trade in public markets for as long as the bonds are privately held."

Further, the guidance in Chapter 10.24 in the NFP Audit Guide states:

"Municipal bonds are issued through negotiated sales, competitive bids, or private placements. In a *negotiated sale*, the issuer or obligor negotiates a price with one or more underwriters. In a *competitive bid sale*, the securities are sold to one or more underwriters who submitted the best acceptable bid(s). The underwriters then resell the securities to the general investing public. Municipal bonds issued in negotiated sales or competitive bids are deemed to be traded in public markets; thus, conduit borrowers under those arrangements are considered public entities for purposes of providing certain disclosures under accounting standards (see the discussion in paragraphs 10.18-.20). In addition, when underwriters sell municipal securities to the general investing public, the SEC imposes certain requirements on the underwriters, who in turn require the obligors to file certain disclosure documents. An overview of SEC considerations related to municipal bonds is provided in the appendix A "Municipal Securities Regulation," of this chapter and in paragraph 15.57-.60. In a *private placement*, the securities generally are sold directly to qualified investors (for example, an institutional investor), rather than through an offering to the general investing public. Municipal bonds issued in private placements are not deemed to trade in public markets because the investors typically are subject to restrictions on resale."

Similar guidance is available in paragraphs 7.07 and 7.12 of the Health Care Audit Guide.

Clarification provided in the TQAs that is relevant to NFPs

Use of the Term "Security" and Types of Securities (TQA 7100.01 and 7100.02)

TQA 7100.01 provides guidance on how entities should evaluate whether their financing instruments are securities. The definition of security in the PBE definition is now linked to the definition of a security in FASB ASC 320, *Investments – Debt and Equity Securities*.

TQA 7100.02 also clarifies that securities may be in the form of equity or debt instruments. For NFPs, the financing instruments are generally in the form of debt instruments or obligations of the NFP (e.g. municipal bonds), which meet the definition of security.

Use of the terms "Conduit Bond Obligor" and "Over-the-Counter" (TQA 7100.03 and 7100.04)

A conduit bond obligor is an entity that is obligated for the repayment of conduit debt securities. As defined in the FASB ASC Master Glossary, conduit debt securities are municipal securities issued by state or local governments, agencies or instrumentalities on behalf of a third-party (e.g., an NFP).

Paragraph BC16 of ASU 2013-12[5] states that an OTC market includes an interdealer quotation or trading system for securities that are not listed on an exchange. TQA 7100.03 also states that markets that are not generally accessible by the public or that do not publish such data points are not OTC markets for the purpose of the PBE definition (i.e., public OTC markets). This would also hold true for the determination of whether the NFP is considered public.

TQA 7100.04 also states that municipal bonds issued in public offerings (when an underwriter purchases municipal securities from an issuer for reoffering to the public) trade thereafter in the public OTC market. However, municipal securities issued in private placements generally are sold directly to qualified investors (e.g., institutional investors); they are not deemed to trade in public OTC markets because the markets in which they are available are limited to only certain investors. The investors are also typically subject to restrictions on resale.

This guidance is consistent with the guidance in the Audit Guides relative to determining whether conduit bonds trade in public markets, as discussed above. The determination of whether the conduit debt is considered to trade in public markets is not based on who purchases the debt securities initially or who holds the debt securities currently, but rather who has the ability to purchase the securities. Since the general public has the ability to purchase the debt securities, conduit debt issued through a negotiated sale or competitive bid would be considered to trade in a public market. This is consistent with TQA 7100.03, which states that public OTC markets are "accessible by the public to execute trades."

Private placements can be analogized to Rule 144A securities. As stated in TQA 7100.14, Rule 144A securities "can only be sold to qualified institutional buyers unless the securities become registered with the SEC. That is, if not registered, such securities are not traded, listed or quoted on an exchange or an OTC market." Since private placement securities are traded similarly to Rule 144A securities, they would not be securities that are traded, listed or quoted on an exchange or an OTC market.

Therefore, although the TQAs were prepared specifically to clarify guidance as to the definition of a PBE (which excludes all NFP entities), the determination of a public OTC market, as discussed in the TQAs, is consistent with the guidance in the Audit Guides, as described above.

MSRB EMMA Data (TQA 7100.05)

TQA 7100.05 clarifies that the Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) is not itself an OTC market. EMMA is the official SEC-designated repository for disclosure documents related to public offerings of municipal securities. EMMA provides historical trade prices, credit ratings and other information related to those securities, but does not allow execution of trades. NFPs that have issued conduit bonds that trade in public markets are required to provide continuing disclosures (including financial statements) on EMMA.

Key takeaway

Each financing instrument should be assessed against the criteria. If the NFP is a conduit bond obligor of municipal securities, the NFP should determine whether these securities are traded in the public OTC market. If so, the NFP would be subject to the accelerated effective dates and/or expanded disclosures imposed on PBEs in the new revenue and lease standards, the upcoming contribution standard (as proposed) and other standards with similar requirements.

[1] Criterion (d) of the FASB Master Glossary definition of a PBE states that a business entity that has issued, or is a conduit bond obligor for, securities that are traded, listed or quoted on an exchange or an over-the-counter market is a PBE.
[2] FASB ASU 2014-09, *Revenue from Contracts with Customers*
[3] FASB ASU 2016-02, *Leases*
[4] FASB Proposed ASU, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*
[5] ASU 2013-12, *Definition of a Public Business Entity – An Addition to the Master Glossary*