Definition of a Publicly Accountable Enterprise

Extract, IFRS Discussion Group Report on Meeting – May 14, 2015

The Preface of the CPA Canada Handbook – Accounting explains that publicly accountable enterprises apply IFRSs in Part I of the Handbook. The Preface provides a definition of a publicly accountable enterprise that consists of two criteria. Meeting either one of these criteria satisfies the definition. The AcSB's definition was largely based on the corresponding definition proposed by the IASB of public accountability (found in the *International Financial Reporting Standard for Small and Medium-sized Entities*). It was also based on the AcSB's experience with non-publicly accountable enterprises when developing and maintaining Section 1300, *Differential Reporting*, in the pre-changeover standards in Part V of the Handbook.

The definition of a publicly accountable enterprise, as stated in paragraph 3(a) of the Preface states:

> "A publicly accountable enterprise is an entity, other than a not-for-profit organization, that:
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> (i) has issued, or is in the process of issuing, debt or equity instruments that are, or will be, outstanding and traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
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> (ii) holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.
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> Banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks typically meet the second criterion above. Other entities may also hold assets in a fiduciary capacity for a broad group of outsiders because they hold and manage financial resources entrusted to them by clients, customers or members not involved in the management of the entity. However, if they do so for reasons incidental to a primary business (as, for example, may be the case for travel or real estate agents, co-operative enterprises requiring a nominal membership deposit, or sellers that receive payment in advance of delivery of the goods or services, such as utility companies), that does not make them publicly accountable."

The marketplace has evolved such that there are new types of entities emerging that have non-traditional structures in terms of raising capital (for example, crowd funding) or being structured as an investment (for example, closed-end funds).

Crowd funding is the raising of funds through the collection of small contributions from the general public using the Internet and social media. More recently, the concept of crowd funding has been extended to raise money for commercial purposes, often to fund the development of singular projects (for example, products which have reached a certain stage of design and development, but require additional funding to be brought into commercial production).

Closed-end funds refer to a type of investment fund that is non-redeemable. Closed-end funds may be structured as investment or mutual funds, or as corporations or capital trusts. They are created to attract funds for collective investment, and are managed with specific investment strategies and goals.

Unlike open-end funds, investors are unable to directly redeem the net asset value of their investments. Instead, liquidation must occur through wind-down of the fund or through sale of the closed-end fund units to third parties.

The Group's Discussion

Group members observed there are factors to consider when determining whether an entity meets the definition of a publicly accountable enterprise. These factors include whether it can be supported that there is a public market, whether the investors are considered a broad group of outsiders, and whether the entity is holding assets in a fiduciary capacity as one of its primary businesses. Group members noted that there is no bright-line test in applying the definition, thus judgment is required. However, there are resources available to assist in making such determination. For example, there are Q&As published by the SME Implementation Group on the interpretation of terms such as "traded in a public market" and "public accountability".

An observation was made that entities raising capital in non-traditional markets appear to be blurring the distinction between private and public enterprises. It appears that complications arise when assessing these non-traditional structured entities over a period of time. A few Group members expressed some comments for consideration. For example, comments were made on whether the assessment of an "outsider" would change when an individual starts to receive detailed project updates after investing in the entity, and whether the platform used for raising capital would continue to exist to facilitate public market trading. Another comment was made about the need to consider the motive of the investor involved in these non-traditional forms of raising capital to determine if the entity has fiduciary responsibility. For example, are these investors expecting a return such that it lends towards an equity model or do they only want to see this value proposition succeed such that it is like a donation-type model? It was also noted that the four Parts of the CPA Canada Handbook – Accounting were created to serve the needs of users that have a different purpose in the way they use financial statements. Thus, it is important to consider what the financial reporting objective is of these non-traditional structured entities and the effect that objective would have on their users.

The Group's discussion raises awareness about the item. No further action is recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).