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Via email to director@fasb.org

Ms. Hillary H. Salo, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Chapter 4: Elements of Financial Statements (File Reference No. 2020-500)

Dear Ms. Salo:

We appreciate the opportunity to respond to the Board's exposure draft on the portion of the conceptual framework addressing elements of financial statements.

We support the Board's efforts to improve the concepts for these elements compared to the existing discussion in FASB Concepts Statement No. 6. A sound foundation is essential to developing high-quality accounting standards, and we commend the Board for investing its time and resources in this project. In most cases, we agree with the Board's tentative conclusions and believe they can be supplemented with additional discussion and illustrations to enhance future standard setting.

However, we also believe certain aspects of the proposal may result in outcomes that do not provide an additional benefit for financial statement users. Our detailed responses and suggestions to the Questions for Respondents are contained in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Gautam Goswami at (312) 616-4631 or Adam Brown at (214) 665-0673.

Very truly yours,

BDO USA, LLP

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Appendix

Question 1—The Board expects that most assets that met the definition of an asset in FASB Concepts Statement No. 6, Elements of Financial Statements, will continue to qualify as assets under the definition of an asset in this proposed chapter. Do you agree that the definition of an asset in this proposed chapter is consistent with the Board's assertion? If not, please provide examples.

We agree that most items meeting the definition of an asset in Concepts Statement No. 6 will also qualify as assets under the proposed definition.

We note that some items are recognized by entities as assets even though they may not meet the current definition in Concepts Statement No. 6. This stems from accounting conventions developed in practice instead of a basis under the conceptual framework. We suggest clarifying how the proposed definition of an asset would apply to those items in order to illustrate the underlying concepts. For example, would a lease deposit for potential damage to the leased asset that will be returned at the end of the lease term meet the proposed definition of an asset? Arguably, the lessee does not control or have the right to the future economic benefits until, and if, the deposit is returned. Some other examples where it may not be clear whether the conceptual definition of an asset is met include:

(a) Initial direct costs in a lease incurred by a lessee
(b) Costs to obtain and fulfill a contract with a customer[1]
(c) Fees paid by a customer in a cloud computing arrangement
(d) Debt issuance costs
(e) Goodwill

As indicated in the lease deposit example, we believe that contrasting examples of when present rights with uncertain amounts (or timing) do or do not represent an asset would clarify paragraph E30. Specifically, if the Board envisions any scenarios that would narrow the scope of expenditures that qualify as an asset, it may be helpful to specify them.

Question 2—In particular, respondents are asked to focus on internally generated intangible assets. Is the definition of an asset in this proposed chapter helpful in resolving issues of identifying intangible assets?

We believe the proposed definition of an asset would benefit from additional guidance for resolving issues related to the identification of internally generated intangible assets. A list of indicators or contrasting examples in paragraphs E35 and E36 might assist the Board (and other constituents) in determining when an internally generated item is capable of being separated and exchanged for something of value. For instance, the Board might consider incorporating concepts in current GAAP for capitalizing an intangible asset (e.g. the asset is capable of being exchanged when it first has an alternative future use). Otherwise, entities may form different views regarding the point at which an asset can be first exchanged, which could lead to diversity.

Further, the latter half of the discussion in paragraph E36 indicates a license for highway or riparian rights may provide benefits to the licensee, even though they are not exclusive to the licensee.

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[1] We note paragraph BC308 of ASU 2014-09, *Revenue from Contracts with Customers*, indicates that fulfillment costs can be recognized as assets without specifying an underlying conceptual basis.

Exclusivity seems to be unrelated to the concepts of separability and transferability that are addressed in the first half of this paragraph. Instead, the highway and riparian right examples seem more closely associated with the Board's thinking in paragraph E25 since they convey non-exlusive benefits.

Question 3—The Board's definition of an asset in this proposed chapter does not include the term control. However, this proposed chapter explains why and how control is interrelated to the definition of an asset. Is this discussion sufficient or is the term control necessary to include in the definition of an asset? If the term control is necessary to include, please explain how its inclusion would change the population of items that would meet the definition of an asset in this proposed chapter.

We generally agree with the Alternative View beginning in paragraph BC4.39 that would maintain "control" in the definition of an asset. While we agree that the term "present right" in the proposed asset definition *implies* the presence of control, we believe it is helpful to make the notion of control explicit, remaining aligned with the IASB on this point. We note that control is one of the concepts reflected in existing guidance (e.g., ASC 805, Business Combinations; ASC 860, Transfers and Servicing), including several recent updates (e.g., ASC 606, Revenue from Contracts with Customers; ASC 842, Leases; ASC 810, Consolidation). Accordingly, it seems helpful to retain the notion of control in the framework, consistent with the Board's thinking at the standards-setting level.

In addition, we suggest elevating the clarifications in paragraph BC4.16 regarding misunderstandings of "control" to the main body of the Conceptual Framework. However, in that context, the discussion of trade receivables is somewhat unclear. In our experience, preparers and auditors do not often confuse a right to consideration with subsequent collection of that receivable.

As to the Board's further question, consider an example of payments related to an entity's workforce. Paragraph E20 indicates that the ability to restrict others' access is a component of an asset because the ability to restrict creates an advantage in the form of privileged access and control of economic benefits. In that context, does an employment contract that restricts working for other entities for a specific time period create an advantage in the form of privileged access and control of economic benefits, such that a signing bonus paid at the time that the contract is executed would represent an asset?

Question 4—The Board decided that an obligation to transfer either assets or, in certain limited circumstances, an entity's own shares would meet the definition of a liability. Is the discussion in this proposed chapter of the limited circumstances in which the entity's own shares would meet the definition of a liability sufficiently clear?

We suggest enhancing the discussion of certain share-settled obligations as a liability by incorporating the relevant concepts from Statement No. 150.[2] For example, paragraph B17 of SFAS No. 150 indicates that certain financial instruments embodying obligations to issue shares place the holder in a position fundamentally different from the position of a holder of the issuer's equity shares. Such obligations do not result in an ownership relationship and therefore represent liabilities. These concepts dovetail with paragraph E58 of the exposure draft.

[2] Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity

We agree a liability encompasses an obligation to transfers assets (including goods) and services. However, we are concerned by the idea that an obligation to transfer a fixed numer of common shares represents a liability, when the shares themselves are equity, consistent with paragraph E67.[3] In contrast to a contract with a variable number of shares equal to a fixed monetary amount, the economics of holding an option on a fixed number of shares reflects an ownership relationship. Therefore, the Board might consider narrowing the scope of what constitutes a liability under the proposal.

Further, we observe that a share puttable at the option of the holder may meet the proposed definition of a liability, i.e., a present obligation of an entity to transfer an economic benefit. It would be helpful to clarify the Board's intent on this point since redeemable shares are not currently considered liabilities under the Codification.

Question 5—Other than as described in Question 4, to allow certain share-settled instruments to be liabilities, the Board expects the liabilities that met the definition of a liability in Concepts Statement 6 will continue to qualify as liabilities under the definition of a liability in this proposed chapter. Do you agree that the definition of a liability in this proposed chapter is consistent with the Board's assertion? If not, please provide examples.

We agree that most items that qualified as liabilities under the definition of a liability in Concepts Statement No. 6 will also qualify as liabilities under the proposed definition.

We note that an essential characteristic of a liability is that an obligation exists. We suggest clarifying whether and how this notion aligns with the indexation concept in ASC 815-40-15-7D if an instrument's settlement terms provide for any potential adjustment, regardless of the probability of such adjustment(s) *or whether such adjustments are in the entity's control*.

Question 6—In practice, the more challenging applications of the definition of a liability in Concepts Statement 6 were related to business risks, constructive obligations, and stand-ready obligations. Is the discussion of those three areas in this proposed chapter adequate to understand and apply the definition of a liability?

We generally agree with the information included in Paragraphs E47 through E54 of the proposal. In that context, a discussion of how the revised definition of a liability might apply to the following items would be helpful:

(a) Business risks: we agree a business risk results in a liability at the point in time the entity first becomes obligated. In this light, it would be useful to explore the differences between executory contracts that are not liabilities (such as firm commitments) compared to those that are (such as lease liabilities).

(b) Constructive obligations – what type of constructive obligations should be recognized? For instance, assume the reporting entity has a compelling business need to raise capital to sustain

[3] We recommend clarifying in paragraph BC4.31 that obligations settled in shares representing a "specific value" includes both a defined and a determinable amount, consistent with the discussion in paragraph E58.

itself as a going concern. Would that represent a constructive obligation to recognize a liability to transfer consideration to an existing resource provider whose instrument requires such a payment upon a subsequent financing? In current practice, there are diverse views about what constitutes an "obligation" under ASC 480 when an instrument settles in a variable number of shares tied to a fixed monetary amount upon a future financing because a reporting entity can always avoid raising capital. That is, there is no "obligation" to raise capital, even though the entity may have strong incentives to do so. Is there a substance over form concept in determining when a constructive obligation meets the revised liability definition?

(c) Equitable obligations – What are some examples or indicators of the nature and type of ethical or moral obligations that conceptually should be recognized as liabilities? Are equitable obligations a form of contingent liability, subject to a recognition threshold?

Question 7—The Board suggested that integration with presentation principles would be helpful in distinguishing between the components of comprehensive income. To facilitate this distinction, paragraph E92 of this proposed chapter references presentation principles. Is distinguishing revenues from gains and expenses from losses essential as a matter of elements, or should those distinctions be exclusively a matter for presentation concepts? Please explain.

We believe a difference exists between the components of comprehensive income and presentation guidance. Therefore, we would retain the the notion of '*ongoing major or central operations'* in the definitions of these components to distinguish revenues from gains and expenses from losses. We believe that the frequency (or recurrence) of an item in the ordinary course of business is a meaningful concept. For instance, in our experience, users are likely to discount a one-time gain from the sale of a corporate headquarters when analyzing an entity's quality of earnings.

The stakeholder outreach and feedback obtained in finalizing the new revenue recognition standard highlights the importance of revenue as a primary element of the financial statements. And while the concept of '*ordinary activities*' is retained in the definition of a customer in Topic 606, there are other types of revenue that are not subject to the guidance in Topic 606 where this principle may be helpful as noted in our response to Question 8.

Question 8—As described in Question 7, this proposed chapter seeks to distinguish between revenues, expenses, gains, and losses. Do the definitions of and other explanatory language related to revenues, expenses, gains, and losses make the distinction between these elements sufficiently clear?

As noted above, we believe the Board should retain the reference to the entity's '*ongoing major or central operations*' in the existing definitions of revenues and expenses to distinguish them from other components of comprehensive income.

For example, when an entity enters into a collaboration arrangement under ASC 808, *Collaborative Arrangements*, the determination of whether the counterparty to the arrangement is a "customer" under ASC 606, *Revenue from Contracts with Customers*, will often affect whether the inflows from the contract should be reflected in the financial statements as revenue or contra-expense. Another area that might be affected relates to damages received in a lawsuit from a counterparty. If the payments derive from a contract with a customer, they may affect the amount of revenue recognized whereas reimbursements from other contracts would not. Another potential issue (though less prevalent in the US) relates to government assistance. For instance, funds were recently provided under the CARES Act to a variety of entities affected by the COVID-19 pandemic. Absent the reference to '*ongoing major or central operations*' in the revenue definition, business entities may interpret the updated definition of 'Revenues' in an overly-broad manner, which could result in diversity for users.

Question 9—The Board has concluded that, other than when exceptions are specifically noted in this proposed chapter, the elements described in this proposed chapter would apply to not-for-profit organizations. Do you agree with this conclusion?

We support the Board's conclusion to apply the same elements for all entities. While the presentation in each of the financial statements is different due to the inherent characterstics of a not-for-profit entity (e.g., equity), the elements themselves should be the same.

Question 10—This proposed chapter was developed on the basis of Concepts Statement 6, though several paragraphs have been removed or adapted. Are any of the paragraphs from Concepts Statement 6 that have been removed in drafting this proposed chapter necessary to keep? If so, why?

We believe the Board should retain the control notion in the definition of an asset for the reasons mentioned in our response to Question 1.

In addition, it may be useful to preserve some discussion related to the concept of probability. For example, in a legal dispute between counterparties to a contract, applying the relevant accounting guidance to a claim about a breach of the contract by one of the parties might result in the conclusion that the claim has no merit and that an outflow of economic benefits is remote. On the other hand, applying the definition in the proposal may result in the entity disregarding the likelihood for future outflow of economic benefits, which might change the conclusion. Therefore, we recommend maintaining the notion of probability in order to promote comparability.

Question 11—"Appendix A: Accrual Accounting and Related Concepts," includes discussion of several concepts that are used in this proposed chapter and in other chapters of the Conceptual Framework. Is this material helpful in a chapter discussing the elements of financial statements?

We recommend incorporating a discussion of accruals and deferrals in the context of whether and how deposits, intial costs and other items align with the proposed definitions of an asset or liability (perhaps as examples), rather than as a separate appendix.