Date: November 11, 2020

Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
Sent via email

RE: Proposed Statement of Financial Accounting Concepts, Concepts Statement No. 8, Conceptual Framework for Financial Reporting. Chapter 4: Elements of Statements. File Reference No. 2020-500

Technical director:

We are Masters of Accounting students at Case Western Reserve University in Cleveland, Ohio. We appreciate the opportunity to respond to the Concepts Statement No.8, Conceptual Framework for Financial Reporting as part of a group assignment for our Advanced Accounting Theory class at the college. We limited our responses to answering six questions rather than answering all questions and while we were in agreement with some points, we also mentioned things that were unclear to us.

We support the overall statement and the points made in it. We did think that including definitions of measurement and recognition for some elements such as internally generated intangible assets would be helpful.

In the Appendix you will find our responses to a few of the Questions for Respondents.

If you have any questions regarding our comments, please contact Mohammed Alomrey at mxa722@case.edu, Vedica Jha at vaj16@case.edu, or Kobe Wanko at kuw@case.edu.

Sincerely,

Mohammed Alomrey, Vedica Jha, Kobe Wanko

Appendix

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?

The proposed chapter touches upon intangible assets and somewhat describes how they fit into the definition of an asset, such as contracts and trademarks being a present right, that give the company legal rights and future economic benefits and therefore qualify as intangible assets. The chapter also states that some assets may qualify as intangible "even if they are not separable or exchangeable" because something like a license can still be used to produce or distribute goods or services, perhaps even exclusively. Therefore, it meets the definition of an asset.

However, we do not believe the proposed chapter helps in resolving issues of identifying internally generated intangible assets. As we read the statement, we did not see anything with regards to how an internally generated asset should be identified, treated or measured or how those issues should be resolved. Internally generated intangible assets are elements for which we believe recognition and measurement should be included along with the definition of the elements. We think this would help assess the element more holistically. It could also be linked separately along with the definitions in order to not elongate the length of the statement, while still having immediate access to the measurement and recognition of some specific complex elements such as internally generated intangible assets. Due to the lack of clarity of the definition with respect to internally generated intangible assets, it is also unclear how we may compare internally generated intangible assets of one entity to the internally generated intangible assets of another entity.

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.

Yes, we believe that the discussion in the chapter from BC4.14 to BC4.18 is sufficient to support the exclusion of the term control in the definition of an asset. In fact it provides a longer explanation relative to other terms. Our first concern with the inclusion of the term control was that its inclusion may confuse entities due to the use and significance of the term control within business combinations or the consolidation method of accounting. The chapter addresses that concern and states that as a reason to support its exclusion of the word control, which we support.

We also agree that while the "notion of control" is important to maintain, because it establishes an implication of control within any present right, the term specifically would only create confusion due to usage in other accounting definitions.

Control could also imply that the entity can control the outcome of the present right future economic benefit, i.e. it could ensure that any asset for which they have a present right for would guarantee a future economic benefit. However, an asset only gives an entity the present right and not a guarantee to the collection or receipt of the future economic benefit as illustrated in the trade receivables example (BC4.16) in the chapter.

Furthermore, we read the alternative view that supports the inclusion of control in the definition of an asset as opposed to just in the explanatory paragraphs. We see an explanation of why including control in the definition would "mitigate potential misapplication of the definition to economic resources to which an entity has a right but no ability to control" due to the comparison with the International Accounting Standards Board (IASB) and their reason to include control (BC4.42). While that is a good point, and in general the convergence of FASB and IASB is important, we believe the heavy use of the term control within business combinations and the consolidation method of accounting within US GAAP still stands, and therefore we believe that for US GAAP, the inclusion of control would create confusion and is not sufficiently important. In addition, the fact that it is both implied and mentioned in the explanatory paragraphs helps clarify that air space or a road outside an entity are not assets. Therefore, we believe the cases where entities could claim these to be assets due to the lack of the term control specifically in the definition of an asset are rare and negligible.

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?

First, the definition of business risks are risks that happen on the job to damage or lose items suddenly. It does have more than one definition because risks have different levels. For example, transportation companies have the risk of getting into accidents. In Concepts Statement No. 6 when the entity exists and cannot record the risk then it will not be appropriate to apply it as a liability unless the liability itself can be incurred. For example, if you work in the oil and gas industry, there is a risk that mining property used in the operations may be destroyed or refined gasoline in gas stations may be set on fire. You cannot record business risks as a liability until that risk occurs or gives rise to a legal obligation from the entity. We agree the risks are not considered a liability until that event happens. Determining when a business risk makes an entity presently obligated requires analysis of the facts, and the event happened in that time.

Second, constructive obligation is an obligation that arises out of conduct and intent rather than a legal contract. Moreover, to apply this concept to liability, the constructive obligations must be accounted for as liability if it happens other criteria that need recording as a liability. In addition, constructive obligations are created by situation, not agreement. However, we agree the company should evaluate the situations or facts of constructive obligations to see the level of standards setting.

Third, stand-ready obligations exist when a company promises to make itself available to provide goods and services to the customer over a period of time. The stand time could arise when companies sell products or services to customers, and have to ship it to them at a specific time. In this chapter, it was not discussed in detail how stand-ready obligations give rise to incurred liabilities upon the entity. As such, the discussion of stand-ready obligations did not further reinforce the identification or application of liabilities mentioned in this section of Chapter 4. However, there is a glimpse of how this concept can lead to the creation of liabilities because stand-ready obligations create future performance obligations. And, any event that compromises these performance obligations has the potential to create liabilities, as described by the chapter. This is why determining when and why an obligation exists (regardless of whether it stems from a stand-ready obligation) is a critical element in identifying potential liabilities. However, if an entity is presently obligated, it may be an obligation with an unknown outcome. We believe stand-ready obligations are important to know what liabilities a company has, and sometimes companies are not sure if they have the correct liabilities to record.

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?

Yes, for the most part the definition of gains and revenues, losses and expenses are clear except for a few areas that we believe need clarification. While it has been noted that revenues are "inflows or other enhancements of assets" and gains are "increases in equity (net assets)", there is no subsequent statement definitively stating that revenues occur through the ongoing and major operations of the entity (a sentiment that is later expressed in the Alternative View). Although E84 gives examples of activities that would be included in an entity's central operations (rendering or producing goods, rendering services, other activities), and E86 states that gains arise from activities or transactions other than those that produce revenues, there is still a vague notion of what "other activities" give rise to revenues or gains. The same can be said of the distinction given to expenses and losses which essentially share the same definition as revenues and gains. Another example that can be added to the definition of revenues/expenses to make the distinction more clear is the inclusion of customer interaction. Dealing with customers is more of a main operation for an entity, not a peripheral activity that results in gains and losses, as such it would be imperative to include among “other activities.”

There is also something to be said about the frequency of revenues/gains and expenses/losses. While revenues and expenses are incurred regularly as main operations for the entity continue, gains and losses are more peripheral and lack the same frequency as these other measures of income.

And, although we did not mention the presentation of these income items, we still believe that there is enough of a distinction between revenues/expenses and gains/losses that warrant their own separate definitions despite the concerns mentioned in section BC4.53 of the proposal.

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?

For the most part, we would agree that the elements provided in Chapter 4 apply to not-for-profit organizations. The only clarification that might be needed is the concept of "promise to give," a revenue process unique to not-for-profit organizations when discussing present rights. It was mentioned in paragraph E29 that "Transactions or other events expected to occur in the future do not in themselves give rise to assets today." It goes on to say, "A benefit that is expected only because of an anticipation of the action or performance of either a counterparty or the entity is not a present right." And while this second section indeed does not represent an entity's right to an economic benefit (asset), the first section directly goes against the concept of "promise to give." This concept gives rise to pledge receivables, similar to accounts receivables created from for-profit entities' operations, in that both assets provide future economic benefit owed to the entity. However, pledge receivables do not occur through sales or trade transactions. Instead, the promise gives rise to a binding future transaction from the contributor to the not-for-profit entity. As such, there is an existing economic benefit to the not-for-profit entity when such an event occurs. Therefore, we believe there should be an addition or footnote relaying this exception to potential readers of this chapter.

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

No, we believe that the current iteration of the proposal is sufficient, and no other principles or concepts mentioned in Concepts Statement No. 6 need to be included in this draft. Also, when the company loses control of the asset, it will be derecognized in the balance sheet.