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November 13, 2020

Hillary H. Salo
Senior Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 2020-500

Dear Ms. Salo:

RSM US LLP is pleased to provide feedback on the proposed Statement of Financial Accounting Concepts, *Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4: Elements of Financial Statements* (the "Exposure Draft").

We appreciate the continued efforts on the part of the Financial Accounting Standards Board (FASB) to develop and refine the definitions of elements in financial statements. However, we have some concerns about the proposed changes. We discuss those concerns in the initial section of this comment letter. Our responses to the Questions for Respondents included in the Exposure Draft are included in the Appendix to this letter.

Proposal to remove the term *control* from the definition of an asset

The Exposure Draft proposes to remove the term *control* from the definition of an asset and provides the rationale for this proposal in the Basis for Conclusions, commencing at paragraph BC4.14. We disagree with this proposal and do not find the rationale for removing it to be persuasive. The Exposure Draft notes that the "notion" of control continues to exist in the definition, but we believe that the term itself is an important part of the definition and should be explicitly included. We believe that, given its extensive use elsewhere in the Accounting Standards Codification (ASC), the term should be retained in the Concepts Statement so as to enhance consistency between the Concepts Statements and the standards that are developed using those Statements. For example, the concept of control is utilized in numerous Topics in the Accounting Standards Codification, including, but not limited to:

Topic 606: Revenue from Contracts with Customers

Among many uses of the term *control* in Topic 606, step 5 in the revenue recognition model states:

> Recognize revenue when (or as) the entity satisfies a performance obligation—An entity recognizes revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains *control* of that good or service). [Emphasis added.]

Topic 805: Business Combinations

Among many uses of the term *control* in Topic 805, the definition of a business combination reads, in part:

> A transaction or other event in which an acquirer obtains *control* of one or more businesses. [Emphasis added.]

Topic 810: Consolidation

The consolidation guidance is based upon the ability of the parent company to control another entity. For example, paragraph 810-10-10-1 reads:

> The purpose of consolidated financial statements is to present, primarily for the benefit of the owners and creditors of the parent, the results of operations and the financial position of a parent and all its subsidiaries as if the consolidated group were a single economic entity. There is a presumption that consolidated financial statements are more meaningful than separate financial statements and that they are usually necessary for a fair presentation when one of the entities in the consolidated group directly or indirectly has a *controlling* financial interest in the other entities. [Emphasis added.]

Topics 840 and 842: *Leases*

Paragraph 840-10-15-6 of Topic 840 lists the conditions to consider in determining whether a lease exists. That paragraph includes numerous usages of the term *control*:

> An arrangement conveys the right to use property, plant, or equipment if the arrangement conveys to the purchaser (lessee) the right to *control* the use of the underlying property, plant, or equipment. The right to *control* the use of the underlying property, plant, or equipment is conveyed if any of the following conditions… [Emphasis added.]

Similarly, in Topic 842, the term is used numerous times, including in the definition of a lease:

> A contract is or contains a lease if the contract conveys the right to *control* the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. [Emphasis added.]

Topic 860: Transfers and Servicing

Among many uses of the term in Topic 860, paragraph 860-10-40-4 reads:

> The objective of the following paragraph and related implementation guidance is to determine whether a transferor and its consolidated affiliates included in the financial statements being presented have surrendered *control* over transferred financial assets. [Emphasis added.]

We also believe that eliminating the use of the term *control* could potentially expand the population of items that might qualify as assets and would create a difference between the FASB's guidance and that of the International Accounting Standards Board (IASB) which includes the term in its definition of an asset in paragraph 4.3 of its Conceptual Framework.

Revenues, expenses, gains and losses

We do not agree with the discussion in paragraph BC4.36 that seems to suggest that revenues, expenses, gains and losses might not need to be defined because they are often perceived as matters of presentation. We believe that revenues are sufficiently different than gains (and correspondingly, expenses are sufficiently different than losses) that they merit separate definitions. While we note that the FASB ultimately decided to include definitions of each of these elements, we would recommend that the FASB use the definitions in Concepts Statement 6, including retention of the notion of "ongoing major or central operations" within the definition of revenue and expenses, and recommend defining gains and losses in a manner that would note that they are not part of the major or central operations.

We would also recommend the retention of the definition of revenues in Concepts Statement 6 to preserve alignment with the definition in Topic 606. We do not understand the rationale for changing the definition now, after the existing definition was used throughout the extended period of development of Topic 606.

Responses to Questions for Respondents

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 assets that met the definition of an asset under FASB Concepts Statement No. 6, *Elements of Financial Statements*, will continue to qualify as assets under the definition of an asset in the proposed chapter. However, we believe that it is difficult to make a definitive assertion to that effect.

As alluded to in our introductory comments, we are concerned that the elimination of the term *control* might give rise to additional items that would potentially meet the definition of an asset. For example:

- Would research and development costs meet the definition of an asset? The reporting entity might have accumulated a present right to economic benefits from their efforts.
- How would arrangements containing variable consideration under Topic 606 be accounted for? Would they meet the definition in the Exposure Draft, given that, while the amount of the economic benefit is uncertain, there is a present right to an economic benefit?

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 do not find the definition of an asset in the Exposure Draft to be helpful in determining if internally generated intangible assets would meet the definition of an asset. As noted previously, we believe this is due, to some extent, to the elimination of the word *control* from the definition. We note, however, that the difficulty does not arise solely from elimination of the word *control*. We believe that additional clarity is needed even now to determine if internally generated intangible assets meet the definition of an asset under Concepts Statement 6.

Consider an assembled workforce that has undergone employee training programs. We believe that entities may consider that training to represent future benefits through revenues expected to be generated by improvements in productivity. However, does a present right exist (under the Exposure Draft)? Does the entity "control" the right (under Concepts Statement 6)?

We believe constituents would benefit from a clear statement as to whether internally generated intangible assets meet the proposed definition of an asset in the Exposure Draft, as well as the existing definition of an asset in Concepts Statement 6.

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.*

As noted in our introductory comments and response to Question 1, we believe that the concept of control is commonly used throughout U.S. GAAP, and believe that its proposed elimination could potentially lead to an expansion of items that are recognized as assets.

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 believe that additional clarity is necessary in describing when obligations to deliver the entity's own shares meet the definition of a liability. We recommend amending paragraphs E58 and E67 along the following lines:

Paragraph E58:

> …If arrangements permit or require settlement of obligations by issuance of a variable number of the entity's own shares <u>such that the value the recipient will receive is substantially fixed rather than dependent upon the value of the shares</u>, those shares are essentially being used in lieu of assets to settle an obligation and therefore <u>the obligation </u>meet<u>s</u> the definition of a liability.

Paragraph E67:

> …A second class of instrument considered an equity interest in an entity is a contract or an arrangement that permits the holder to acquire a <u>fixed or substantially</u> fixed number of equity instruments of the entity <u>and does not constitute an obligation for the entity to transfer cash or other assets to the holder</u>…

It is common in practice for there to be some potential variability in the number of shares that will be issued in equity contracts, and we believe that the preceding sentences (as originally drafted) could potentially promulgate form over substance conclusions (i.e., could be interpreted to mean that, if the number of shares to be issued are not fixed, it is a liability regardless of the significance of the potential variability).

Our interpretation, based on other statements in E67 and from BC4.31, is that the intent appears to be that instruments that have a value that varies with the value of the outstanding stock are conceptually equity. Conversely, it appears from certain statements in E58 and from BC4.31 that the intent appears to be that instruments that result in a value to the recipient that is fixed or otherwise doesn't convey the returns and rewards of an equity shareholder are conceptually liabilities. We believe modifications like those proposed above will more clearly convey the intent. The proposed suggestion to add "and does not constitute an obligation for the entity to transfer cash or other assets to the holder," should help to make clear the need to consider whether the equity contract is conceptually a liability for other reasons (e.g., an obligation to transfer cash) given it is not uncommon for equity contracts to include a contingent obligation that may require the issuer to settle the equity contract in cash.

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 obligations that currently meet the definition of liabilities under Concepts Statement No. 6 will continue to qualify as liabilities under the definition of a liability in the Exposure Draft.

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 believe the discussion is clear; however, we have some concern related to executory contracts. We believe that constituents would benefit from the inclusion of a discussion of whether executory contracts create present obligations.

We believe the FASB should also consider whether the definition of an asset should incorporate a similar discussion on executory contracts that could result in assets.

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 that distinguishing between revenues and gains and expenses and losses is not merely a "presentation concept." As noted in our introductory comments, we believe the notion of "ongoing and major or central operations" from Concepts Statement 6 should be retained. We believe it is a fundamental concept and is important to users of financial statements in that it allows them to more accurately assess cash flows of the entity.

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?*

Please see our response to Question 7 above, as well as our introductory comments.

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 generally agree that the elements in this proposed chapter would apply to not-for-profit (NFP) organizations. We have the following comments as they relate to NFPs:

Paragraph E65 states "Equity or net assets is the residual interest in the assets of an entity that remains after deducting its liabilities." We believe that the following changes should be made specific to NFPs to appropriately define net assets:

> Net assets are the residual interest in ~~the~~ <u>recognized</u> assets of an entity that remain after deducting ~~its~~ <u>recognized</u> liabilities.

We believe that the addition of "recognized" is an important concept in the NFP environment because NFP entities may elect to not recognize certain tangible assets on the statement of financial position (such as works of art or national treasures) under certain provisions of GAAP. Additionally, conditional promises to give to the NFP entity, which many have argued to be true assets of the organization, are not recognized until the conditions (as defined by GAAP) are met.

We also would recommend that the FASB clarify the intended meaning of the phrase "…operating purposes not centered on profit" in paragraph E71. While this is a common characteristic, it is not an absolute in terms of how certain organizations are managed.

Lastly, in the first sentence of paragraph E74, we recommend the following change:

More commonly, donors' restrictions ~~permit~~ do not prohibit an entity to pool…

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?*

As noted in previous comments, our main concerns relate to the elimination of *control* from the definition of an asset and the elimination of "ongoing major or central operations" from the definition of revenue.

Question 10: *"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 believe the material is helpful.

We greatly appreciate the efforts the Board has put forth to improve the definitions of the elements of financial statements and the opportunity to provide feedback on this proposed Statement of Financial Accounting Concepts. We would be pleased to respond to any questions the Board or its staff may have concerning our comments and ask that questions be directed to Faye Miller at 410.246.9194 or Richard Stuart at 203.905.5027.

Sincerely,

RSM US LLP

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