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Via email to director@fasb.org

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Exposure Draft - Concepts Statement No. 8, Conceptual Framework for Financial Reporting

Technical Director,

We are graduate students Anthony Kanam, Brett Marcus, and William Walsh, of Case Western Reserve University, pursuing the Master of Accountancy. In our study of accounting history and policy-making, we have been exposed to a number of different conceptual frameworks and we would now like to provide our own insights on an official Concepts Statement.

Overall, we would like to voice our support for the exposure draft addressing the elements of financial statements. We believe that the components defined are in line with the objective of financial reporting defined in E9 as well as in previous concept statements. Having 10 clearly defined components of financial statements streamlines financial reporting.

Considering the purpose of the Concepts Statements is to provide the framework for standard-setting, it alleviates any misunderstanding of what each element could be in a practical setting. When a standard refers to 'comprehensive income' we can trace that term back to this concept statement rather than relying on precedent. It makes the approach to financial reporting normative.

Pertaining to assets, we agree with the definition of both elements under this concept statement with one reservation. We believe the term 'present right' makes it abundantly clear that it is in reference to an economic benefit to which the entity has sufficient control over, otherwise the right would not exist. In terms of providing evidence that a right presently exists, we are still a little unclear as to how this definition would cover certain intangible assets, because some assets are created upon consolidation, and only represent a difference in the value paid for an acquired entity and the value of the entity's components as represented in the financial statements (goodwill). It is unclear how an asset of this nature is in any way linked to an economic benefit under the proposed definition.

Pertaining to liabilities, we also agree with the definition, without reservation. The term 'present obligation' much in the way 'present right' communicates the existence of an obligation that an entity has to provide an economic benefit, an even if that obligation is not settled with the transfer of assets or services but with the transfer of shares, it is understood as the transfer of something of value to the receiving party.

With respect to the exposure draft, we voice our support of the Concepts Statement recognizing the distinct components of the financial statements. Our comments for The Board's selected questions are answered in the attached appendix.

Regards,

Anthony Kanam, Brett Marcus, William Walsh

Appendix: 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.

Yes, it can be said that most assets that met the definition of an asset in FASB Concepts Statement No. 6 also meet the definition of an asset in FASB Concepts Statement No. 8. The main difference between the current definition, "assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events," and the proposed definition, "an asset is a present right of the entity to an economic benefit" deals with the use of the terms "probable," "future", "control," and "past transactions or events."

Ultimately, with the implementation of the new definition, not only will items that qualify as assets under Concept Statement No. 6 qualify as assets under Concept Statement No. 8, but it is likely that even more items will also qualify assets under Concept Statement No. 8.

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?

Yes, the definition of an asset in this proposed chapter is helpful in resolving issues of identifying intangible assets. To start, in E18, the Board states that assets typically have features, contractual, tangible, exchangeable, or separable, that help identify them. The Board follows this statement by saying that these features are not essential characteristics of an asset and their absence is not sufficient to preclude an item from being considered an asset. Given these statements, it is clear that there can be items that are intangible that can qualify as an asset.

When looking at items that may qualify as intangible assets, the Board has made some clear statements. In E27, the Board states that even if an intangible asset is not separable or exchangeable, it may be usable by the entity in producing and distributing goods or services, which in turn would qualify the item as an asset. Additionally, in E28, it is made clear that an item does not have to be purchased or produced to qualify as an asset, other transactions and events can generate assets showing that the means of acquiring rights does not affect whether an item meets the essential characteristics of an asset. When talking about the right to an economic benefit, that is another essential characteristic of an asset, it is made clear in E34 that the ability of an entity to sell, transfer, license, or exchange a right provides evidence that the right presently exists. As a result, the entity controls access to that right and this right leads to an economic benefit. For intangible assets, these rights can be derived from legal contracts, statues, or other means and the existence of these contractual or other legal rights can be seen as a common characteristic of an intangible asset.

Finally, in reference to intangible items that do not arise from rights conveyed in a contract or other legal means, some of these items have the ability to be separated and exchanged for something of value and others cannot be separated from an entity and exchanged for something of value. For items that can be separated and exchanged for something of value, it is clear that a right, which is to an economic benefit, exists. For items that cannot be separated and exchanged for something of value, the intangible item gives an entity the right to something, even if it is not solely their own right, which in turn leads to future economic 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.

In the Board's definition of an asset in this proposed chapter, even though the term control is not included in the definition, the Board is able to sufficiently explain why and how control is interrelated to the definition of an asset through two characteristics that they stated an asset must have. The first characteristic is that "an asset is a present right" and the second characteristic is that "the right is to an economic benefit."

In reference to an asset being a present right, E22 states that a right entitles its holder to have or obtain something or to act in a certain manner. These rights can be obtained in various ways and gives the owner access to economic benefits which include the ability to possess, use, and enjoy the right to sell, donate or exchange the right. E23 follows by saying that legally enforceable rights to economic benefits can be obtained without legal ownership of the underlying benefit itself. In E25, the Board mentions that for an item to qualify as an asset of an entity, an entity does not need to have an exclusive right to the economic benefit, but can have a shared right.

When referring to the right that an economic entity has to an economic benefit, E34 states that the ability of an entity to sell, transfer, license, or exchange a right provides evidence that the right presently exists, the entity controls access to that right, and the right is to an economic benefit. The Board's definition of an asset in this proposed chapter tries to make it clear that an entity should be able to obtain cash inflows or reduce cash outflows as opposed to the previous definition which made it seem that an entity had power to control those assets ability to obtain cash flows or reduce cash outflows.

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?

Yes, the discussion in this proposed chapter regarding the limited circumstances in which the entity's own shares would meet the definition of a liability is sufficiently clear. The Board first talks about this in E57 where they state that an obligation can be fulfilled, satisfied, or settled in a number of ways which can include converting the obligation to equity, or, in certain circumstances, transferring shares of the entity. These obligations are documented so that they include both how the entity is required to fulfill the obligation and by what specific date or when specific events occur. E58 then follows by stating that a transfer of shares sufficient in number is a transfer of economic benefit and can be used to to satisfy an obligation of a determinable or defined amount. These shares that are transferred are considered a liability as they are used instead of assets to satisfy an obligation in arrangements that permit or require the settlement of obligations by issuance of a variable number of the entity's own shares. The Board was able to make this discussion as to whether an entity's own shares would meet the definition of a liability clear in both of these paragraphs.

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.

Yes, we agree with the Board's assertion that items that qualify as liabilities in Concept Statement No.6 will also qualify as liabilities in Concept Statement No. 8. Similar to the change in the definition of an asset, the Board has omitted the terms probable, future, and past transaction or event from the proposed definition.

In reference to the term probable, the current definition states that liabilities are "probable future sacrifices of economic benefits." This is misleading as many people believe that items should only be recognized as liabilities when there is a high probability that they must be paid in the future, however this is wrong and only complicates things. The Board wanted to eliminate this threshold of probability.

The term future was also omitted as the Board believes that the present right to an obligation better suits the definition of a liability. Under the present definition, an entity may only classify an item as a liability once it becomes due. A liability should be recognized as soon as an agreement to provide an economic benefit has been agreed upon.

Also, similar to the definition of an asset, the Board concluded that "past transaction" was redundant and not necessary in the proposed definition of a liability. Finally, the proposed definition makes it clear that an entity is presently obligated as soon as the obligation is legally enforceable.

The difference between the proposed definition and the current definition of a liability is not significant, so not only will items that qualify as liabilities under Concept Statement No. 6 also qualify as liabilities under Concept Statement No. 8, but it is likely that even more items will qualify as liabilities under Concept Statement No. 8 than Concept Statement No. 6.

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?

Concept Statement No. 8 provides the necessary clarification needed to distinguish these types of risks and obligations. As long as uncertainty can be removed from the equation, we understand that a liability has been created.

The discussion of business risks is sufficient in this exposure draft. A business risk should not exist as a liability simply because of their lack of realization. We accept business risks as normal, and even though they may result in large liabilities, the timeline and amount for which those present obligations would be measured at cannot be estimated.

Constructive obligations are also well-defined as obligations that arise that may not be legally enforceable but nonetheless present. As we understand it, a constructive obligation is a present obligation and regardless of how strong the claim to it may be it should still be reported at its most reasonable estimated or exact value as a liability, which is in line with The Board's definition. This definition recognizes the importance of precedent as opposed to simply reporting based only on legally enforceable obligations.

Stand-ready obligations are also clarified, seeing as they cannot be adequately measured in terms of when they will be satisfied or for how much, they are best measured by the offering of options or guarantees which essentially transform stand-ready obligations into present obligations.

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.

Revenues and gains, as well as expenses and losses, should be recognized as separate elements, just as they are recognized as different presentation concepts. We believe that the distinction between these interrelated elements to be a bit lacking. Practically speaking, we understand revenues and expenses as the enhancement or outflow of assets or settlement or creation of liabilities as the result of business activities, i.e. the result of normal operations.

Gains and losses we understand to be those transactions that are not part of normal operations, which means they arise from different types of transactions. Having different inputs that result in the same output, the increase or decrease of equity, does not mean that we should only distinguish them for reporting purposes. There is a certain regularity to revenues and expenses that differentiates them from gains and losses, and seeing these different albeit interrelated concepts as separate elements we believe is important for financial reporting.

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 we believe that the definitions in the chapter of the terms in question do provide a discernible distinction between them. E88 and E89 clarify the differences further and make it clear that the main difference is that there is active and passive income/loss. Gains and losses tend to come from passive activities while revenues and expenses come from regular business activities. The language in the chapter makes this abundantly clear.

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 agree wholeheartedly with his statement. In E9 it is stated, "emphasizes usefulness to present and potential resource providers and others in making rational decisions about allocating resources to not-for-profit entities". Non-profit organizations require elements of business in their administration and the use of accounting standards and principles is necessary for internal and external individuals of the organization. Non-profits have assets, liabilities, shareholders, creditors, and all other forms of business aspects and a lack of profit goal orientation would not alleviate them from the same accounting responsibilities or guidelines of any profit oriented organization.

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?

None that we have identified.

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?

The contents of Appendix A are very useful. An understanding of underlying concepts is necessary to interpret what is presented throughout the rest of the document. While the concepts may be assumed to already be understood by anybody who may be working with this document a refresher and point of reference is never a bad thing to have. It is also properly labeled as an appendix to the chapter as none of the material presented is directly apart of the chapter, but a firm understanding of the material in the Appendix bolster the user’s ability to understand and interpret the chapter as a whole.