ILLINOIS **CPA** SOCIETY™

November 13, 2020

Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2020-500

The Accounting Principles Committee of the Illinois CPA Society ("Committee") appreciates the opportunity to provide its perspective on the proposed *Concepts Statement No. 8, Conceptual Framework for Financial Reporting Chapter 4: Elements of Financial Statements* (herein referred to as the "concepts statement"). The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

The Committee appreciates the efforts of the FASB to update and improve the conceptual framework. However, we do not support issuance of the proposed concepts statement in its current form. As noted in our responses to the questions for respondents, we believe that there is a lack of clarity in the definitions and the explanations provided. In particular, we believe that it would be beneficial to defer finalization of the proposal until the Board addresses recognition and measurement as those issues may impact our views on the definitions of the elements.

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We appreciate the opportunity to provide our comments and observations on the proposed concepts statements and would be pleased to discuss them with the Board members or the FASB staff at your convenience.

Sincerely,

William Keirse, CPA
Chair, Accounting Principles Committee

Matt Mitzen, CPA
Vice Chair, Accounting Principles Committee

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.*

Response: We agree the definition of an asset in the proposed chapter would allow for assets meeting the definition under Concept Statement No. 6 to continue to meet the definition of an asset. We are not sure why only "most assets" that met the definition of an asset in Concepts Statement No. 6 would meet the definition of an asset in the proposed chapter. That suggests there may be some assets that qualified under Concepts Statement No. 6 that would not qualify under the revised definition. The changes the Board is making to the definition of an asset, particularly the removal of the "probable future economic benefit" wording from the definition, seems designed to broaden what could qualify as an asset. If the Board believed that the revised definition would exclude assets that qualified under the Concepts Statement No. 6 definition, it should have noted that in the ED and provided examples of assets that would not qualify.

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?*

Response: We do not believe the revised definition of an asset will help in resolving issues of identifying internally generated intangible assets, especially when considering the discussion in paragraph E35, which summarily concludes that "the costs incurred in those activities [research and development, advertising, training, start-up activities, and pre-operating activities] are not assets". We do not agree that all of these examples fail to meet the definition of an asset. Some of these are examples of where the Board reached a standard's level decision to not recognize an asset. For example, while it may be true that costs incurred in research may not result in a present right to an economic benefit, it may not be true for all costs incurred in developing the results of that research. We note that International Accounting Standards No. 38 Intangible Assets requires the capitalization of development costs following the point at which certain conditions are satisfied. The definition of an asset in Chapter 4 of the IASB's Conceptual Framework for Financial Reporting is consistent with the definition of an asset in Concepts Statement No. 6, and therefore, if costs incurred in development activities give rise to an asset under International Financial Reporting Standards, we see no reason that they would not as well under the Board's proposed definition of an asset or, for that matter, the existing definition of an asset.

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.*

Response: We believe the term control should be included in the definition. As noted in paragraph BC4.14, the definition of an asset "removes the term 'control' while maintaining the notion of control." Further, as noted in the question above, the discussion following the definition explains why and how control is interrelated to the definition of an asset. If the Board believes there is a need to explain why and how control is interrelated to the definition of an asset, it suggests that control is important. Rather than "maintaining the notion of control", we believe it would be preferable to be clear that control is important by maintaining that wording in the definition of an asset. Further, the notion of control is important to the application of many existing standards (Topic 606, Topic 810, Topic 842, Topic 860). While having a present right to an economic benefit suggests that a reporting entity has control, we do not believe eliminating the reference to the term "controlled" in the definition will necessarily eliminate any confusion surrounding the application of the definition and therefore serves no apparent purpose.

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?*

Response: We believe that all obligations to be settled with equity shares would be appropriately classified as liabilities under the proposed definition. By removing the reference to a "sacrifice" of economic benefits, it is no longer sufficiently clear that the thing that is being transferred must also represent an economic benefit to the transferor. In addition, while footnote 11 notes that "the term *provide* has typically been used to describe obligations to perform services or stand ready to do so," the proposed language of "otherwise provide economic benefits" is broad enough to include the issuance of equity shares. Pointing out what has "typically" been done does not clarify how the proposed definition will or should be interpreted currently or in the future.

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.*

Response: The concept of a present obligation is not entirely clear. Paragraph E45 states that transactions or other events expected to occur in the future do not in and of themselves give rise to obligations today. Based on this language, we believe there are some liabilities where the existence of a present obligation is questionable. For example, it is not clear how an unvested benefit represents a present obligation or an asset retirement obligation, which is contingent upon the cease-use date of the asset. It may be useful to discuss how vesting impacts the evaluation of whether a present obligation exists. In addition, as detailed in the answer to Question 6, we have concerns about the evaluation of the existence of a present obligation in the context of stand-ready and constructive obligations. Finally, it is not clear what the intent is in E46. If an entity has a contractual obligation to purchase an asset, it is unclear how the agreed upon purchase price of the asset impacts the existence of a present obligation.

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?*

Response: We believe that there are some points that may require further clarification in order to understand and apply the definition of a liability to stand-ready and constructive obligations.

There are many variations on stand-ready obligations. The Board uses warranties as an example in paragraph E61. In exchange for consideration (the premium) a customer has warranty with both an intrinsic value, the value at a given point in time, and extrinsic value, or time value. The present obligation is created by either the contractual or implicit warranty agreement, and the measurement is impacted by the uncertainty of the future payment. It is not clear, however, whether master supply agreements or master service agreements would be considered a liability under the topic of an equitable or stand-ready obligation. We believe that under the same logic, a master supply agreement to fulfill orders according to standard terms could create a present obligation. The same application uncertainties apply to loan commitments as well. We believe the framework needs to provide additional guidance in determining when a contract represents an option and when it represents an executory contract.

In terms of constructive obligations, it is unclear based on the discussion in paragraph E52, whether repeated engagement in a certain repeated behavior can create a present obligation to make nonreciprocal transfers, such as dividends paid based on a standard dividend policy or annual charitable contributions. In addition, the discussion does not provide information about the time horizon for any liabilities arising because of a constructive obligation. It is unclear whether the present obligation is to make the next payment in the sequence or to make multiple future payments. Finally, it is left uncertain as to whether there is a recognition threshold, or, alternatively, a different recognition threshold for constructive obligations than for contractual/legal obligations.

Paragraph E52 uses a pattern of paying vacation-pay and bonus payments as examples of potential constructive obligations. We do not see these examples as representative of a policy-based obligation. The employer has an obligation to compensate the employee for services rendered and that is the underlying obligation. Payment or nonpayment of a bonus is a matter of measurement uncertainty, not a separate obligation, and therefore, more appropriately addressed under measurement. This is consistent with the Board's discussion of warranties in paragraph E61.

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.*

Response: In our view, gains and losses are more a matter of presentation and perhaps could be better addressed at the standards level. In paragraph E92 where the Board references the presentation principles, they themselves state as much: "Because a primary purpose of distinguishing gains and losses from revenues and expenses is to make displays of financial information about an entity's sources of comprehensive income as useful as possible, fine distinctions between revenue and gains and expenses and losses are principally matters of presentation. Ultimately, those decisions will be made at a standards level with considerations for the objective of financial reporting and presentation concepts". If the Board truly believes that the distinctions are matters of presentation best left to standard level guidance within the context of the presentation concepts, then we believe that it is better to not try and make the distinction in the Elements chapter, rather than to do so ineffectively. If the Board does try to distinguish revenues from gains and expenses from losses in the Elements chapter, we recommend that they take a different approach than the definitions currently provided in the exposure draft (see our response to Question 8), as we do not believe the proposed definitions are effective at making that distinction.

In addition, we believe that the Board is missing an opportunity to provide much needed guidance for consideration of when items should be included as part of other comprehensive income. We believe that the Board should address this in either the Elements or the Presentation chapters. In the exposure draft for Chapter 7 – Presentation, the Board stated: "Differences between earnings and comprehensive income of business enterprises exist because past standards have required or permitted several types of items to be excluded from net income and later reclassified into net income. There is no conceptual basis for determining which items qualify for that treatment." (Chapter 7 – PR31). We do not agree with this statement.

Paragraph 7.17 of the IASB Conceptual Framework states: "However, in developing Standards, the Board may decide in exceptional circumstances that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance for that period." We recommend that the Board use the IASB approach to other comprehensive income as a starting point and develop a conceptual basis that aligns with current standards and practice. For example:

- The use of other comprehensive income for a cash flow hedge allows the statement of financial position to include fair value measurements and comprehensive income to record changes in fair value measurements, while net income for the transaction continues to be recognized at amortized cost, with recognition when the hedged transaction affects net income. Other comprehensive income is a measure of risk in the event the forecasted cash flows do not occur and net income reflects information about margins.
- The use of other comprehensive income for available for sale investments allows the statement of financial position to include fair value measurements and comprehensive income to record changes in fair value measurements that are relevant if the financial instrument were to be sold, while net income for the investment continues to be recognized at amortized cost with changes in net income that are relevant if the financial instrument were to be held.

In these examples, both components of comprehensive income are relevant as both are predictive of future cash flows under different scenarios. We believe that the Board could create conceptual guidance that would leverage the use of other comprehensive income in situations in which both fair value and amortized cost reasonably provide decision-useful information to the financial statement users. At the very least, we believe that the Board consider Ms. Botosan's recommendation in paragraph BC4.48 to develop a definition of Comprehensive Income that aligns more closely with the concept economic income, in an effort to create a more powerful definition for the purpose of standard setting.

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***?**

Response: We do not believe that the definitions of and other explanatory language related to revenues, expenses, gains, and losses make the distinction between those elements sufficiently clear. We believe that the language "from delivering or producing goods, rendering services, or carrying out other activities" included in both the revenue and expense definitions to be too broad. Under these definitions, anything could be a revenue or expense, and it is unclear how to identify items that are not revenues or expenses. We recognize that the Board tries to narrow it by defining "other activities" in paragraph E88 as "…those activities that permit others to use the entity's resources, which result in interest, rent, royalties, and fees" as well as including charitable contributions, but we believe that this guidance is not clear enough and is too focused on historical examples, as opposed to conceptual guidance, to effectively eliminate items that should not be revenues and expenses. Gains and losses are defined as increases or decreases in net assets that are not revenues or expenses. We believe that the overly broad definition of revenue and expense makes it difficult, if not impossible, to identify items that are gains and losses.

It may be more useful to distinguish revenues from gains and expenses from losses based on the business model of the reporting entity. For example, we believe it would be useful to distinguish between:

- gains and losses that arise from investing activities, where the amounts are determined by market forces and arise from exchange transactions of standalone assets or liabilities, and

- revenues and expenses that arise from managing groups of assets and liabilities to arbitrage input and output markets and produce goods and services.

We note that those are fundamentally different business models with different risks and that the surplus or deficit from either has different persistence, and hence differing relevance to the users of the financial statements. Such information could also align better with the information on the statement of cash flows which already presents a distinction between cash flows from investing activities and cash flows from operations.

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?*

Response: Overall, we do not agree. We note significant differences in the concept of equity, the nature of assets, and the relevance of information about activities to users so that it would be better for all concerned to have separate chapters.

Perhaps the most obvious difference is net assets or equity. The equity of a corporate entity is a contractual arrangement between investors and the entity. The investors have rights to the equity and expect a return on and of their investment. The net assets of a nonprofit are owned by the entity and subject only to the specific terms of the charter and donor restrictions and general legal constraints.

This difference extends to the concept of revenue and expense. The users of the financial statements of a nonprofit typically are not interested in using information about margins and earnings to assess future cash flows. There are no future cash flows to owners, and the future cash flows of a nonprofit do not typically have the same predictive value as the operating earnings of an enterprise. Users are frequently more interested in determining how donated funds have been used and the extent of administrative overhead as a prediction of the utility of future contributions to the extent there is a focus on future cash flows as opposed to stewardship.

Finally, many assets of nonprofits are restricted or otherwise not available to settle obligations of the entity. A forest preserve or a historic household might be in the nature of a public resource that the entity has stewardship over rather than an economic benefit of the entity. Such assets may impose implicit obligations regarding preservation and maintenance.

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?*

Response: We do not agree with the presentation of information about accrual accounting and the related concepts in a separate appendix. We believe that this information is integral to understanding financial reporting standards. By placing this information in a separate appendix, the main concepts statement arguably reflects elements and comprehensive income from a perspective of financial assets and liabilities and a purely asset/liability approach, while ignoring how accruals and deferrals, or a revenue/expense approach, are still necessary in providing decision-useful information to financial statement users. While we note that the Board has previously stated a preference for the asset/liability approach in standard setting, the use of deferrals is not an issue confined to legacy standards. Recent standards include examples of deferrals, often displayed as basis adjustments or in other comprehensive income. For example:

- ASU 2014-09 Revenue for Contracts with Customers, requires various deferrals in the form of contract assets and liabilities.

- ASU 2016-02, Leases, requires adjustment of the basis of the right of use asset for lease incentives, deferred rent, and deferral of initial direct costs.

- ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs relocates deferred issuance costs from recognition as a separate asset to a basis adjustment of discount or premium.

- ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities, permits recognition of excluded items into other comprehensive income with allocation into income over time.

The continued existence of these deferrals is evidence that it is not a workable solution to apply a pure asset/liability approach in financial reporting. One could go so far as to suggest that there are differences between the concepts of financial assets and liabilities and nonfinancial assets and liabilities, and that those differences should be recognized by defining multiple types of assets and liabilities. Regardless, we believe that the need for and use of accruals and deferrals should be included in the main discussion of elements and not relegated to an appendix.

APPENDIX A
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2020-2021

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:	
Large: (national & regional)	
Ryan Brady, CPA	Grant Thornton LLP
Ashley Carboni, CPA	KPMG LLP
Michael Couillard, CPA	Baker Tilly Virchow Krause LLP
Matthew Denton, CPA	Sikich LLP
Jason Eaves, CPA	Crowe LLP
William Keirse, CPA (Chair)	Ernst & Young LLP
Melissa Lynch, CPA	Plante Moran, PLLC
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David Wentzel, CPA	Crowe LLP
Medium: (more than 40 professionals)	
Danielle Martin, CPA	Porte Brown LLC
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Small: (less than 40 professionals)	
Peggy Brady, CPA	Selden Fox, Ltd.
Brian Kot, CPA	Cray Kaiser Ltd CPAs
Matthew Mitzen, CPA (Vice Chair)	Bronswick Benjamin P.C.
Educators:	
Mollie Adams, CPA	Bradley University
John Hepp, CPA	University of Illinois at Urbana-Champaign
Industry:	
John Bercerril, CPA	Elkay Manufacturing
Jeffrey Ellis, CPA	FTI Consulting, Inc.
Michael Maffei, CPA	GATX Corporation
Thomas Masterson, CPA	Medix
Elizabeth Prossnitz, CPA	Consultant
Lisa Sezonov, CPA	Northern Trust
Richard Tarapchak, CPA	Reynolds Group Holdings
William Wang, CPA	Union Tank Car Company
Daniel Wilfong, CPA	Ansira, Inc.

Staff Representative: Rafael Wiesenberg, CPA — Illinois CPA Society