WIPFLI
10000 Innovation Drive
Suite 250
Milwaukee, WI 53226
Ph: 414.431.9300
wipfli.com

MindtheGAAP
making the complex understandable
Mind the GAAP, LLC
1649 Linda Drive
West Chester, PA 19380
773 732 0654
mindthegaap.com

October 21, 2020

Ms. Hillary H. Salo
Technical Director
File reference No. 2020-500
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Dear Ms. Salo:

Mind the GAAP, LLC and Wipfli LLP appreciate the opportunity to comment on the FASB's Proposed Statement of Financial Accounting Concepts – Concepts Statement 8 – *Conceptual Framework for Financial Reporting – Chapter 4, Elements of Financial Statements* (hereafter referred to as the "Exposure Draft").

We support the Board's decision to revisit/update the definitions of certain elements of financial statements to reflect recent changes in practices and standards. However, we do have some feedback on certain of the proposed changes in the Exposure Draft, which we have highlighted in the introductory section of this letter. Appendix A contains our responses to the Questions for Respondents posed in the Exposure Draft.

Removal of the Term *Control* from the Definition of an Asset

The Exposure Draft proposes to remove the term "control" from the definition of an asset. We do not support this change.

While we understand that the discussion around "present rights" in paragraphs E22-E30 retains the *notion* of control, we believe that it is important to explicitly use that term when defining an asset. The foundational principles behind many Accounting Standards Codification ("ASC") Topics are based on the concept of control – including but not limited to:

ASC 606, *Revenues from Contracts with Customers*	Revenue is recognized when *control* over a good or service is transferred to a customer.
ASC 805, *Business Combinations*	A business combination occurs when one or more acquirers obtain *control* over a business.
ASC 810, *Consolidation*	An investor should consolidate entities in which it possesses a *controlling* financial interest.
ASC 842, *Leases*	A lease is a contract that conveys the right to *control* the use of an identified asset for a period of time in exchange for consideration.
ASC 860, *Transfers and Servicing*	A transferred financial assets should be considered sold and therefore should be derecognized if *control* is surrendered.
ASC 958, *Not-for-Profit Entities*	The accounting for a split-interest agreement is dependent upon whether the organization or a third party is the trustee or otherwise *controls* the contributed assets.

In general, a number of U.S. GAAP standards state or imply that when a reporting entity controls a future economic benefit, a corresponding asset is recognized. Conversely, that asset is derecognized when the reporting entity consumes or loses control of the future economic benefit.

Because the concept of control is so ingrained throughout U.S. GAAP, we believe that it is critical to include the term "control" in any definition of an asset. Moreover, we are concerned that the wording proposed in the Exposure Draft – i.e., that an asset represents a "present right" to an economic benefit – may be misinterpreted in practice. For example, we could envision some organizations asserting that the following items meet the proposed definition of an asset:

- Research and development ("R&D") costs, because the work performed to date provides the entity with a present right to economic benefits that result from the R&D efforts
- Employees and assembled workforce, as these individuals are presently providing services solely to the reporting entity, and which allow for revenues (i.e., economic benefits) to be generated
- Internally generated goodwill, because the entity's synergies (a present right) create value (economic benefits) reflected in the entity's share price exceeding the carrying value of its net assets

Finally, we are troubled that the removal of the term *control* could result in inconsistent recognition of assets between entities that report under U.S. GAAP and IFRS, as the IASB's definition of an asset continues to include the word *control*.

In sum, we believe that *control* is an essential characteristic of an asset and that the definition of an asset should expressly include the word "control". One possible way to do so is to indicate that an asset represents a *present right to control a future economic benefit*.

Characteristics of Liabilities

The proposed essential characteristics of liabilities appear to be symmetrical with the proposed essential characteristics of assets. Specifically, an asset is defined as a *present right to an economic benefit*, while a liability represents a *present obligation to transfer or provide economic benefits to others*. We note that paragraphs E50 through E54 suggest that liabilities may include equitable or constructive obligations. Given the symmetry in the essential characteristics of assets and liabilities, we are slightly concerned that an entity may attempt to recognize an asset merely because the counterparty has a constructive or equitable obligation. Again, we feel that reinserting the word "control" into the definition of an asset would help to mitigate this concern.

Separately, we believe that the discussion around liabilities (and perhaps assets as well) should include reference to executory contracts, where parties have a contractual obligation to perform in the future in exchange for consideration. We believe that the Board should indicate its views as to whether executory contracts meet the essential characteristics of a liability and, if not, why. We believe this discussion is very relevant given the new requirements in ASC Topic 842, *Leases* – where right of use assets and lease obligations are recognized – versus (for example) the accounting for cloud-computing agreements assessed as a service under Accounting Standards Update 2018-15[1], where economically similar assets and liabilities are not recorded.

[1] *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*

Revenues, Expenses, Gains, and Losses

Notwithstanding the guidance in paragraphs E89-E92, we believe that the proposed definition of revenues in E84 is not adequately distinguished from the definition of gains in E86.[2] We note that in the existing Concepts Statement No. 6, revenue represents inflows from "the entity's ongoing major or central operations". We believe that a similar concept should be reintroduced into the Exposure Draft to help preparers and users of financial statements to differentiate between revenues and gains. The Board may also want to consider further distinguishing revenues from gains by indicating that revenues arise from transactions with customers or from carrying out other activities as part of the entity's ongoing major or central operations.

In addition, we believe that the circumstances described in paragraph E89(b), which distinguishes losses from expenses, should be clarified. We are concerned that the current language in this subparagraph can be construed to require presentation of certain adjustments to assets and liabilities as losses rather than as expenses. For example, we believe that revisions of bad debt reserves, recognition of impairments, and changes in estimated litigation provisions are "adjustments to estimates of reported assets and liabilities" that should be reported as an expense rather than as a loss. However, the language in E89(b) may imply that these types of adjustments instead should be presented as losses.

Finally, we believe that the Exposure Draft should explain the concept of other comprehensive income ("OCI") and distinguish elements of OCI from gains and losses. Specifically, the Board should explain when and why certain transactions should be reported in other comprehensive income (and presented outside of the income statement) versus gains and losses.[3] The lack of discussion around the concept of other comprehensive income appears to be an important omission from the Exposure Draft.

Applicability to Not-For-Profit Entities

We appreciate that the Exposure Draft discusses how the definitions of financial statement elements apply to both for-profit and not-for-profit entities. However, we would recommend a few additional clarifications and enhancements specific to not-for-profit entities. Paragraph E29 begins: "Transactions or other events expected to occur in the future do not in themselves give rise to assets today." However, this language could be inadvertently construed to preclude recognition of assets for promises to give at not-for-profit entities. We would suggest adding some discussion at the end of E29 that distinguishes between a promise to give (an asset representing a not-for-profit entity's right to an economic benefit) versus an "anticipation of the action or performance" of a counterparty (not an asset).

Finally, the wording in paragraph E84 may unintentionally devalue the primary revenue activities of not-for-profits. In that paragraph, revenues are defined as "inflows or other enhancements of assets of an entity or settlements of its liabilities … from delivering or producing goods, rendering services, *or carrying out other activities*." [emphasis added] We initially were confused as to why "other activities" would not instead be reported as gains, but later realized (in paragraph E88) that this term includes "rent, royalties, and fees" as well as "charitable contributions received". To avoid potential confusion, we suggest that a second sentence be added to E84 stating that "Other activities could include those activities that permit others to use the entity's resources – resulting in interest, rent, royalties, and fees – or for not-for-profit entities, charitable contributions received." The last two sentences in E88 could then be deleted.

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[2] There may be a similar challenge in distinguishing expenses in paragraph E85 from losses described in paragraph E87.

[3] For example, unrealized gains and losses from investments in equity securities are reported within the income statement, while unrealized gains and losses from available for sale debt securities are typically recorded in OCI, outside of the income statement.

Additional Feedback

We applaud the FASB for taking a fresh look at the Concept Statements; they are important foundational documents. Ideally, we believe that all of the Concept Statements should be incorporated directly into the Codification, elevating their authoritative status. Because the Concept Statements are currently non-authoritative, there is no requirement for the Board to consider them in developing new, or amending existing, accounting guidelines. Including the Concept Statements within authoritative U.S. GAAP would promote conceptual consistency across topical areas and would be akin to how the Conceptual Framework forms an integral part of IFRS.

Finally, as a minor point of feedback, we concur that any obligation to transfer or provide economic benefits to others meets the definition of a liability. In our view, it does not matter whether the obligation ultimately will be settled in cash, other assets, or the entity's own shares. More specifically, obligations that could be settled in either a fixed or variable number of the entity's shares would seem to meet the definition of a liability. Hence, we would suggest amending the last sentence of paragraph E58 as follows: "If arrangements permit or require settlement of obligations by issuance of ~~a variable number of~~ the entity's own shares, those shares are essentially being used in lieu of assets to settle an obligation and therefore meet the definition of a liability."

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Again, we thank you for your efforts in trying to strengthen and improve the definitions of the fundamental elements of financial reporting. If you have any questions regarding the contents of this letter, please contact Scott Ehrlich, President of Mind the GAAP, at (773) 732-0654 or Zachary Mayer, Partner at Wipfli, at (608) 270-2909.

Sincerely,

Mind the GAAP

Mind the GAAP, LLC

Wipfli LLP

Wipfli LLP

Appendix A

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 the proposed chapter is consistent with the Board's assertion? If not, please provide examples.*

Yes. In fact, we believe the new definition of an asset may be interpreted more permissively than the existing definition in Concept Statement No. 6. It may be the case that the new definition could result in potentially *more* items being recognized as an asset due to removing the word "control".

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?*

No. Under the Concept Statement No. 6, it was clearer that to recognize an asset, an entity must control the economic benefits. By removing the word "control" from the definition of an asset, it may make it more difficult for entities to discern whether to recognize an asset for internally generated intangible assets. To use an example mentioned in the introduction to this letter, entities would not recognize an asset for internally generated assembled workforce under the current definition of an asset. However, we could foresee arguments to recognize an asset for this internally generated intangible asset under the proposed definition of an asset in the Exposure Draft.

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.*

Consistent with Ms. Botosan's view in paragraph BC4.42, we believe that discussion of control should be elevated from subsequent explanatory paragraphs and explicitly integrated into the definition of an asset. As discussed in the introduction to this letter, the concept of control is ingrained throughout U.S. GAAP, in standards such as ASC 860 (transfers and servicing of financial assets), ASC 805 (business combinations) and ASC 842 (leases). Because the concept of control is so pervasive, we believe that it is critical to explicitly include the term "control" in any definition of an asset. Without express reference to control, we are concerned that entities could potentially consider research and development, employee base, and possibly even internally generated goodwill as assets under the Exposure Draft definition.

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?*

The discussion is clear, although we believe that regardless of whether the settlement is through a fixed or variable number of shares, the obligation remains the same. As indicated in the earlier portion of this letter, we would propose to amend paragraph E58 as follows: "If arrangements permit or require settlement of obligations by issuance of ~~a variable number of~~ the entity's own shares, those shares are essentially being used in lieu of assets to settle an obligation and therefore meet the definition of a liability."

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 the Board's view that obligations meeting 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.

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?*

Yes. However, we believe that the discussion around liabilities (and perhaps assets as well) should include reference to executory contracts, where parties have a contractual obligation to perform in the future in exchange for consideration. We believe that the chapter should explain whether executory contracts meet the essential characteristics of a liability and, if not, why. As mentioned earlier, we believe this discussion is very relevant given the new requirements in ASC Topic 842, *Leases* – where rights of use assets and lease obligation are recognized – versus (for example) the accounting for cloud-computing agreements assessed as a service under Accounting Standards Update 2018-15, where economically similar assets and liabilities are not recorded.

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 support distinguishing gains from revenues, and losses from expenses, as part of the discussion of elements of financial statements. In fact, we feel the discussion in the Exposure Draft is too limited, as the proposed definition of revenues in E84 is not adequately distinguished from the definition of gains in E86. We note that in the existing Concepts Statement No. 6, revenue represents inflows from "the entity's ongoing major or central operations". We believe that a similar phrasing should be reintroduced into the Exposure Draft to help preparers and users of financial statements differentiate between revenues and gains. The Board may also want to consider further distinguishing revenues from gains by indicating the former arises from transactions with customers or from carrying out other activities as part of the entity's ongoing major or central operations.

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?*

No. Please see our response to Question 7 above, as well as earlier comment in the introduction to this letter.

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?*

Yes. However, we feel there are improvements that can be made to the Exposure Draft to better reflect how the definitions of the various elements would apply to not-for-profit entities. For example, paragraph E29 begins: "Transactions or other events expected to occur in the future do not in themselves give rise to assets today." However, this language could be inadvertently construed to preclude recognition of assets for promises to give at not-for-profit entities. We would suggest adding some discussion at the end of E29 that distinguishes between a promise to give (an asset) and an "anticipation of the action or performance" of a counterparty (not an asset). In addition, the wording in paragraph E84 may unintentionally devalue the primary revenue activities of not-for-profits. In that paragraph, revenues are defined as "inflows or other enhancements of assets of an entity or settlements of its liabilities … from delivering or producing goods, rendering services, *or carrying out other activities*." [emphasis added] As the term "other activities" is not clear in the context of paragraphs E84, we suggest that a second sentence be added to E84 stating that "Other activities could include those activities that permit others to use the entity's resources– resulting in interest, rent, royalties, and fees – or for not-for-profit entities, charitable contributions received." The last two sentences in E88 could then be deleted.

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 indicted previously, we are mainly concerned by the removal of control from definition from asset and the elimination of the concept of "ongoing major or central operations" from the definition of revenue.

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?*

Yes. Concepts used throughout in the Exposure Draft are reliant upon employing an accrual basis of accounting. Items like assets, liabilities, revenues, expenses, gains, and losses are dependent on the occurrence of an event (e.g., giving rise to a present right or a present obligation). Such events often will not immediately involve the transfer of cash.