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Committee on Corporate Reporting

November 13, 2020

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

Re: File Reference No. 2020-500

Dear Ms. Salo,

This letter is submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Financial Accounting Standards Board's (FASB or "the Board") proposed Statement of Financial Accounting Concepts, *Concepts Statement No. 8, Conceptual Framework for Financial Reporting: Chapter 4: Elements of Financial Statements* ("the proposal" or "the Exposure Draft").

FEI is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives, and other senior-level financial executives. CCR is a technical committee of FEI comprised of approximately 50 Chief Accounting Officers and Corporate Controllers from Fortune 100 and other large public companies, representing approximately $12.3 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the SEC, FASB, and PCAOB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary

CCR appreciates the Board's effort to develop an improved conceptual framework for the development of future accounting standards. CCR supports the objectives of clarifying the elements definitions, making the language internally consistent, and eliminating repetition. However, CCR believes the current elements definitions in Concepts Statement No. 6, Elements of Financial Statements (CON 6) are well understood and consistently applied. Furthermore, CCR does not believe that the misconceptions and misapplications cited by the Board generate pervasive diversity in practice or misleading financial information. CCR would appreciate further clarification from the Board as to why revising the elements definitions is a priority at this time.

CCR believes that the removal of terms including "probable," "control," and "ongoing major or central operations" effectively expands the elements definitions and likely creates more problems than it resolves. Furthermore, CCR believes many of the proposed changes are likely to unnecessarily impact both current practice and future standard setting, and many of the Board's objectives can be achieved through minor revisions to CON 6. To this end, CCR recommends retaining the term "probable" in the asset and liability definitions, retaining the term "control" in the asset definition, and leaving the revenues, expenses, gains, and losses definitions unchanged. CCR also recommends further clarification and expanded examples in key areas, as described below.

Asset

Removal of "Probable"

CCR is opposed to removing probable from the asset definition. CCR believes removing probable will increase not only the population of items that would meet the asset definition, but also the cost, complexity, and inconsistency of financial reporting. Instead, CCR recommends retaining probable in the asset definition and aligning its meaning with the more commonly used technical meaning of "likely to occur."

Inconsistent Use of Probable: This section provides context for CCR's view that the definition of probable as used in the asset definition should be changed to probable's more commonly used technical meaning of "likely to occur."

Two definitions of probable are used throughout standards-level guidance:

- **Technical Meaning:** The most common application of probable in practice ("technical meaning") is defined in the FASB Master Glossary as "likely to occur," which many consistently apply as a threshold in the 70-80 percent range.[1]
- **General Meaning:** The other application of probable in practice ("general meaning") is defined in paragraph 25, footnote 18 of CON 6 as, "that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved." No commonly applied threshold exists for the general meaning of probable.

Both meanings of probable are defined in the FASB Master Glossary. The technical definition is hyperlinked to numerous standards, such as Topics 310, 360, 450, 606, 815, and 842, and is clearly widespread in its use throughout standards-level guidance. The general definition of probable is hyperlinked only to Topic 840, which will be superseded after all entities transition to Topic 842. Other instances of the general meaning do occur in standards-level guidance, such as when determining whether to capitalize costs incurred for internal-use software,[2] yet the intended meaning for probable in these instances is often found only by reference to the Board's basis for conclusions for the guidance as originally issued. Even then, source documents are sometimes unclear about which meaning of probable was intended.[3] Consequently, CCR believes it is reasonable that many preparers apply the technical meaning of probable in all instances, including in the asset definition, to promote consistency throughout financial reporting.

Because many preparers already apply the technical meaning of probable in all instances of the term, CCR recommends retaining probable in the asset definition and aligning its meaning with the technical meaning. Although outside the scope of this project, CCR also recommends aligning all other uses of probable throughout standards-level guidance with the technical meaning. CCR notes several instances in which the Board has already moved in this direction, such as by changing from the general meaning of probable in Topic 840 to the technical meaning of probable required by Topic 842, and by changing the general meaning of probable in paragraph 9 of FAS 71 to the technical meaning of probable required today in ASC 980-340-25-1. CCR believes alignment in how probable is used throughout financial reporting will reduce confusion among

[1] A former FASB Board member similarly referenced a 70-75 percent range in the dissenting view of ASU 2014-15.

[2] The uses of probable in ASC 350-40-25-7, 25-12, and 25-13 refer specifically to the general meaning of probable defined in CON 6 – see paragraph 62 of Statement of Position No. 98-1.

[3] For example, in paragraph 14 of Statement of Financial Accounting Standards (FAS) No. 43, the Board supports the existence of a liability by drawing a parallel to the use of the technical meaning of probable in FAS 5.

preparers, increase consistency in how probable is applied, and better reflect how many preparers already apply the term in practice.

Increase in the Asset Population: CCR believes that the application of probable in the asset definition as a threshold (i.e., "likely to occur") may be pervasive to the point that its removal could increase the population of items that would meet the asset definition. For example, preparers in the pharmaceutical industry sometimes must determine whether pre-launch inventory meets the asset definition prior to regulatory approval for commercial sale. This analysis hinges on whether a probable future economic benefit exists despite the uncertainty of receiving approval. Under the proposed definition, preparers may determine that pre-launch inventory meets the asset definition earlier, as removal of probable could be interpreted as removing a required threshold of certainty for the future economic benefit. A similar outcome results in some collaborative arrangements, as outlined in the following section, when contracts governing the arrangements grant exclusive rights to an entity.

Increase in Cost and Complexity: Removing probable from the asset definition is likely to increase not only the population of items that would meet the asset definition, but also the cost and complexity of financial reporting. For example, collaborative arrangements are often governed by contracts that grant the right to use, research, develop, manufacture, and/or commercialize future products. Entities often simplify questions of recognition and measurement related to these rights by precluding recognition on the basis that these rights do not meet the asset definition[4] because their future economic benefits are not "likely to occur." However, under the proposed asset definition, these present rights may qualify as assets, leaving entities to evaluate more complex recognition and measurement questions regardless of the probability that these rights will lead to future economic benefit. Producing valuations for these highly uncertain assets would likely increase costs and complexity, particularly when an objectively observable fair value is not readily available. Furthermore, if such uncertain assets are recognized, the need to systematically track and potentially write down these assets could significantly increase costs for preparers and may cause confusion for users in understanding an entity's financial results.

Uncertainty

Using the technical meaning rather than the general meaning of probable in the asset definition would mitigate many of the concerns expressed in the following paragraphs by effectively causing most uncertainties related to economic benefit to impact existence rather than measurement. CCR believes that, where possible, uncertainty should impact existence rather than measurement because such an approach is widely applied in practice and reduces much of the cost and complexity associated with challenging valuations. However, because the Board has expressed interest in having uncertainty impact measurement, CCR would like to highlight several concerns with how the Exposure Draft addresses uncertainty. Specifically, CCR is concerned with the discussion of uncertain economic benefits in paragraphs E30, E35, and E36—especially in light of previous comments made by the Board (quoted below) and inconsistencies in current standards-level guidance—that could cause confusion and inconsistent application in practice.

Amount vs Existence of Economic Benefit: Paragraph E30 introduces the concept that uncertainty as to the amount of economic benefit should affect the measurement rather than the existence of an asset. However, paragraph E35 then discusses activities in which the existence, as opposed to the amount, of future economic benefit is uncertain. Specifically, paragraph E35 mentions that costs incurred for activities carried out with

[4]Paragraph 63 of FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises (CON 5)

the expectation of obtaining an economic benefit in the future are not assets. Although paragraphs E30 and E35 treat these two situations as distinct, CCR believes significant judgment is often involved in determining whether uncertain future economic benefit should affect the measurement or the existence of an asset. Without further clarification, these conflicting ideas could lead to diverse applications in practice.

For example, suppose an entity purchases or obtains control of a license to intellectual property (IP) prior to the IP's approval by regulators. Because future economic benefit may depend solely upon whether the IP is approved, some may determine that no economic benefit exists until approval is granted. That is, as suggested in paragraph E35, costs to purchase the license are incurred with only the expectation of obtaining an economic benefit in the future and, therefore, are not an asset. Others may determine that uncertainty about approval is reflected in measuring the fair value of the license. That is, the license is a present right with uncertain amounts and timing, as suggested in paragraph E30, and a right to economic benefit is evidenced by the ability to separate the license and exchange it for something of value, as stated in paragraph E36. Although standards-level guidance may assist in accounting for such transactions, CCR recommends clarifying these paragraphs to promote consistency in the future development, revision, and interpretation of accounting standards, as illustrated in the following paragraph.

Research and Development Costs: Paragraph E35 specifically mentions that research and development (R&D) costs are not assets. CCR believes this statement may cause confusion, as certain R&D costs are capitalized in practice,[5] and the Board has previously stated that in-process R&D (IPR&D) acquired in a business combination generally will satisfy the asset definition "because the observable exchange at the acquisition date provides evidence that the parties to the exchange expect future economic benefits to result from that research and development."[6] CCR recommends that the Board reconcile these contradictory views, as paragraph E35 may prove important to future decisions by the Board on accounting for R&D costs. If reconciling these views is beyond the scope of this project, CCR recommends clarifying the concept presented in paragraph E35 and excluding R&D costs as a specific example. CCR also recommends clarifying how the final wording may influence future Board decisions on projects that address the accounting for R&D costs.

Concerns with Fair Value: The Board has previously stated that "uncertainty about the outcome of an individual project is reflected in measuring its fair value."[7] Given the Board's intention to more closely associate the uncertainty of economic benefit with measurement (see paragraph E30), CCR requests clarification on whether the Board also intends to more frequently incorporate fair value measurement into standards-level guidance. CCR is concerned that such actions could significantly increase the costs and complexity of financial reporting when an objectively observable fair value is not readily available.

Removal of Control

CCR is opposed to removing the term "control" from the asset definition. CCR believes that control is fundamental to both key standards and the application of the asset definition, and its removal may unnecessarily alter the population of assets.

Control is Fundamental to Key Standards: CCR believes that control should be retained in the asset definition because the concept of control is fundamental to key accounting standards, and its use in these standards is explicitly tied to control as used in the asset definition. For example, the Basis for Conclusions of ASU 2014-

[5] ASC 985-20-25-3
[6] FAS 141R, B152
[7] FAS 141R, B152

09, *Revenue from Contracts with Customers (Topic 606)*, notes, "The Boards' description of control is based on the meaning of control in the definitions of an asset in the Boards' respective conceptual frameworks. Thus, the Boards determined that control of a promised good or service (that is, an asset) is the customer's ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset" (ASU 2014-09, BC120). Similarly, The Basis for Conclusions of ASU 2016-02, *Leases (Topic 842)*, notes that one of the standard's purposes is to "align the concept of control, as it is used in the definition of a lease, more closely with the control principle in both Topic 606… and Topic 810."

Because the Board intended for control in the definition of a lease to more closely align with control as used in accounting for both consolidations and revenue—the latter of which refers explicitly to the meaning of control in CON 6—it is unclear why the Board is concerned that control may sometimes be applied in the same way as in consolidation accounting. If the Board intends for control to be applied in a different way within the context of the asset definition, CCR believes providing a clear definition of control would resolve this concern more effectively than removing control from the asset definition. Therefore, CCR recommends adding a clear definition of control to the Exposure Draft. CCR notes that a clear definition of control should be included regardless of whether control is removed from the asset definition, as the notion of control remains an important part of the proposal.

Control is Fundamental to Applying the Asset Definition: CCR also believes control should be retained in the asset definition because the concept of control is fundamental to the application of the asset definition. For example, one aspect of control is the ability to restrict access. Because the Board excludes control from the asset definition, the asset definition cannot be correctly applied without the Board's later qualification that present rights that are not restricted are not assets of an entity.[8] CCR believes including control in the asset definition clarifies that these items inherently are not assets. Additionally, CCR expects that, regardless of whether control is retained in the asset definition, indicators of control will remain a primary resource utilized by preparers in determining whether an entity has a present right. Therefore, retaining control in the asset definition accurately reflects how preparers will practically apply the asset definition.

Control and the Ability to Restrict Access: CCR is concerned that paragraph E20, which discusses the notion of control, places too much emphasis on the ability to restrict access. CCR believes that the current asset definition allows for more judgment in determining whether an entity controls future economic benefit, and the emphasis on one aspect of control (i.e., the ability to restrict access) may alter the population of items that would meet the asset definition. For example, an entity may pay a city for the construction of increased capacity of public utilities (e.g., water) in support of its manufacturing process. In this case, the entity has effectively provided financing to the city, as the construction costs would otherwise have been passed along to the entity in the form of higher rates. Furthermore, the additional utilities directly increase the entity's manufacturing capacity, thereby providing future economic benefit in the form of increased future cash flows. The entity controls the net increase in future cash flows arising from the costs incurred to increase the capacity of the public utilities, yet the entity cannot restrict the local utility from also using the utilities for other projects. Therefore, the costs incurred to increase capacity of public utilities may qualify as an asset under the current asset definition but may not qualify as an asset under the proposed asset definition.

Divergence from IFRS: While acknowledging that convergence with IFRS is not a primary consideration of the Board, CCR nevertheless does not see a compelling reason to diverge further from the IASB's Conceptual Framework by removing control from the asset definition. Separation at a conceptual level is particularly

[8] Paragraph E20 of the proposal

concerning because of its diverging influence on future standard-setting projects and potential to increase the complexity for multi-national entities preparing financial statements in accordance with both U.S. GAAP and local statutory compliance requirements.

CCR's Response to the Board's Rationale for Removing Control from the Asset Definition

In the Basis for Conclusions of the proposal, the Board provides rationale for removing control from the asset definition. However, CCR believes that removing control does not resolve the problems raised by the Board. Furthermore, CCR believes that these problems can be adequately addressed without removing control from the asset definition, as explained in the following paragraphs.

Improper Application of Control: The Board's first reason for removing control, as stated in paragraph BC4.16, is because some constituents improperly apply control "in the same manner as described in business combinations or consolidation accounting." CCR believes that the Board's decision to remove control from the asset definition does not resolve the Board's concern, as the proposal continues to use the term "control" without clearly defining it. Consequently, CCR believes the consistency of control's application will likely remain unchanged. Furthermore, as discussed previously, the concept of control in Topic 810 appears to be connected to the concept of control presented in CON 6, which calls into question the Board's assertion that some constituents improperly apply control as described in consolidation accounting. To clarify this issue and increase the consistency in which control is applied, CCR recommends retaining control in the asset definition and adding a clear definition of control to the Exposure Draft to explain how the Board intends for the term to be applied.

Improper Identification of What is Controlled: The Board's second reason for removing control, as stated in BC4.18, is because some constituents failed to identify that "what is controlled is the existing right that gives rise to the economic benefits… rather than the economic benefits themselves." However, CCR believes that the proposal does not underscore this distinction sufficiently to prevent further misunderstanding of what is controlled. For example, the term "control" is used three times in the proposal in three different ways:

- Paragraph E17 mentions controlling access to the economic benefit
- Paragraph E20 mentions control of economic benefits
- Paragraph E34 mentions controlling access to a present right

The inconsistency with which control is used diminishes its usefulness and creates confusion about the Board's intent that control should refer to control of the present right. CCR therefore recommends including control in the asset definition in such a way that what is being controlled is clear, utilizing additional explanatory language as necessary.

Liability

Variable number of shares

CCR supports the Board's decision to allow limited circumstances in which an entity's own shares would meet the definition of a liability. CCR believes that the discussion around these limited circumstances is clear and appreciates that this change further aligns the Conceptual Framework with standards-level guidance.[9]

[9] ASC 480-10-25-14

Removal of probable

CCR is opposed to removing the term "probable" from the liability definition for reasons similar to those described above in the asset section. That is, CCR believes removing probable will increase the population of items that would meet the liability definition and increase the cost, complexity, and inconsistency of financial reporting. CCR recommends retaining probable in the liability definition and aligning its meaning with the more commonly used technical meaning of "likely to occur."

Inconsistent Use of Probable: As noted above, probable is used throughout standards-level guidance with two different meanings, referred to here as the technical meaning and the general meaning. Standards-level guidance frequently uses the technical meaning to require that a probable threshold be met before a liability is recognized, such as in accounting for loss contingencies,[10] contractual termination benefits,[11] other postemployment benefits,[12] and compensated absences.[13] Because standards-level guidance for liabilities almost always applies probable using its technical meaning, many preparers also use probable as a liability recognition policy in the absence of standards-level guidance. Removal of probable from the liability definition could be interpreted as removing any perceived connection between the use of probable in standards-level guidance and the Conceptual Framework, which may cause preparers to change their policies accordingly. Although perhaps the Board intends for this change to occur, CCR does not believe such a change is necessary, as the current application of probable as a threshold in the liability definition is widely used and well understood. If the Board nevertheless feels that removing probable is necessary, CCR recommends evaluating the costs and benefits of creating such a shift in practice.

Increase in the Liability Population: CCR believes that removing probable from the liability definition may have consequences similar to those stated in the asset section above. That is, despite the Board's intention[14] that probable not be used as a threshold, CCR believes that more items would meet the liability definition due to the perceived removal of a threshold of likelihood for the future sacrifices of economic benefits. For example, an entity may enter into contracts with milestone payments contingent on the achievement of key milestones in a product's development and commercialization. Under the current liability definition, CCR views these payments as a contractual commitment but may not recognize a liability due to uncertainty as to the future sacrifice of economic benefit. However, under the proposed liability definition, these contractual obligations could be interpreted as meeting the liability definition regardless of whether it is probable that the milestones will be reached.

Increase in Cost and Complexity: As with the asset definition, CCR is concerned that removing probable from the liability definition will unnecessarily increase the cost and complexity of financial reporting. ASC 805-20-25-2 states, "To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in [CON 6] at the acquisition date." Many preparers reference this guidance during acquisition accounting to not recognize a liability when a future sacrifice of economic benefit is not probable. Under the proposed liability definition, preparers are more likely to consider any present obligation as a liability, regardless of the probability that the obligation may result in the future sacrifice of economic benefit. This shift in practice would increase the cost and

[10] ASC 450-20-25-2
[11] ASC 712-10-25-2
[12] ASC 712-10-25-5 defers to ASC 450-20-25-2 when accounting for postemployment benefits within the scope of Subtopic 712-10 that do not meet the conditions in ASC 710-10-25-1
[13] ASC 710-10-25-1
[14] Paragraph BC4.10 of the proposal

complexity of financial reporting because all present obligations, regardless of their probabilities of future sacrifices of economic benefits, would require entities to address more costly and complex measurement issues.

Business risks, constructive obligations, stand-ready obligations, and contingent liabilities

CCR appreciates the discussion contained within paragraphs E47-E64 on business risks, constructive obligations, and stand-ready obligations. Although CCR would prefer the use of a less graphic example in paragraph E47 to illustrate business risks, the examples in these paragraphs are helpful in applying the liability definition in challenging situations. To further enhance the helpfulness of these explanatory paragraphs, CCR has the following recommendations related to constructive obligations and contingent liabilities.

Constructive Obligations: CCR notes that paragraph BC4.26 includes a quote from paragraph 36 of CON 6 that the Board cites as useful in determining whether a constructive obligation exists. However, the quoted text does not appear in the Exposure Draft. CCR recommends retaining this language from CON 6 to assist in identifying constructive obligations, as the identification of constructive obligations is often complex and subject to significant judgment.

Contingent Liabilities: CCR recommends including in paragraph E64 additional details and specific examples of contingent liabilities, as was done with business risks, constructive obligations, and stand-ready obligations. Specifically, CCR recommends including contrasting examples of contingent liabilities to help preparers differentiate uncertainty as to the existence of a present obligation from uncertainty as to a liability's measurement. For example, a possible outcome of many contingent liabilities is that no obligation exists due to the occurrence or nonoccurrence of a future event. In this case, measurement may impact existence if the expected loss is essentially zero.

Loss contingencies

Although the Conceptual Framework need not always align with standards-level guidance, CCR is concerned that the proposal does not address the inconsistency between the liability definition and the accounting for loss contingencies, which often requires accrual of a liability in the absence of a present obligation. For example, during litigation, an entity may experience an unfavorable pre-trial event that makes it probable that a liability has been incurred. Because it is probable that a liability has been incurred, and assuming the amount of the liability can be reasonably estimated, the entity is required to record a liability despite the absence of a present obligation, which may not exist until final settlement of the lawsuit. Paragraph E64 also may contribute to confusion in this area by stating, "Absent a present obligation, the occurrence or nonoccurrence of a future event does not by itself give rise to a liability." In the prior example, the unfavorable pre-trial event occurred in the absence of a present obligation, yet the event gave rise to a liability.

Given the potential for confusion in this area and the pervasiveness of loss contingencies in practice, CCR recommends addressing loss contingencies directly as a type of contingent liability. This clarification is needed particularly because FAS 5 (codified in ASC 450-20) predates the current Conceptual Framework, and the Board has not addressed how loss contingencies do or do not meet the current liability definition.

Onerous contracts

CCR is concerned with language in paragraph E46 that reads, "[A] contractual obligation that requires an entity to pay more than the fair value of the asset at the transaction date may create a liability before the asset is received, reflecting what the entity might have to pay to undo the unfavorable contract." This language is very similar to the definition of onerous contracts in IAS 37 and could be interpreted as requiring accrual of a liability for all onerous contracts not otherwise within the scope of standards-level guidance. Furthermore, this is the only instance in which the term "fair value" is used in the proposal, and CCR is concerned that its inclusion may create additional complexity in financial reporting in the absence of objectively observable fair values.

Because the Board has not created a comprehensive framework for accounting for onerous contracts, diversity in practice exists as to how entities account for obligations arising from onerous contracts not otherwise within the scope of standards-level guidance. CCR believes that the above-quoted language from paragraph E46 may reduce this diversity; however, it may also have far-reaching consequences unintended by the Board. For example, paragraph E46 may imply that entities should accrue losses on all loss contracts with customers rather than only on those contracts in the scope of standards-level guidance.[15] Similarly, paragraph E46 may imply that entities should accrue losses on all firm purchase commitments rather than only when required by standards-level guidance.[16] CCR recommends evaluating the magnitude of these potential changes before including such language in the proposed chapter.

Revenues, Expenses, Gains, and Losses

CCR does not agree with the Board's suggested changes to the definitions of revenues, expenses, gains, and losses. CCR believes that the existing definitions are well understood, and the proposed definitions are not sufficiently clear to assist in classifying items of significant judgment. The lack of clarity around the proposed definitions is particularly concerning because, despite the Board's intent that distinguishing revenues from gains and expenses from losses be principally a matter of presentation addressed at the standards level, very little standards-level presentation and classification guidance exists, and many preparers rely on the current elements definitions and discussion for guidance. Additionally, CCR agrees with Ms. Botosan's concern that creating conflicting definitions of revenue between Topic 606 and the Conceptual Framework is far from ideal and may contribute to confusion in practice. Given the magnitude of these concerns, CCR recommends retaining the current definitions of revenues, expenses, gains, and losses as they stand in CON 6.

If the Board decides *not* to retain the current definitions, CCR recommends adding a more robust discussion to aid in distinguishing revenues from gains and expenses from losses. Such a discussion should include, as did CON 6, language that contrasts activities constituting an entity's "ongoing major or central operations" from transactions that are merely "peripheral or incidental."

The remainder of this section explains (1) why the term "ongoing major or central operations" should be retained, (2) why the proposed definitions and adjoining discussion are not helpful in classifying items of significant judgment, and (3) CCR's suggested approach to certain presentation issues.

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[15] Paragraph BC296 of ASU 2014-09 outlines the Boards' decision to retain existing guidance for loss contracts rather than include an onerous test in Topic 606.

[16] The EITF discussed loss recognition for firmly committed executory contracts in EITF Issues 99-14 and 00-26, and some Task Force members believed that loss recognition by establishing a liability is only appropriate when required by standards-level guidance. However, the EITF discontinued work on the issue, citing a lack of authoritative guidance and observing that "the accounting for executory contracts is an extremely broad topic with significant and pervasive implications on financial reporting."

Ongoing Major or Central Operations

In paragraph BC4.37, the Board states that it removed the term "ongoing major or central operations" because it is unclear "whether the term *ongoing major or central operations* is intended to refer to all revenues and expenses or only those that relate to revenues and expenses from other activities." CCR does not agree that the application of "ongoing major or central operations" is unclear. In fact, CCR believes its application is well understood, and its inclusion in the revenues and expenses definitions reduces, rather than contributes to, diversity in practice. The following paragraphs highlight several reasons why CCR believes the Board should retain the term "ongoing major or central operations" regardless of whether the Board accepts CCR's recommendation to retain the revenues, expenses, gains, and losses definitions found in CON 6.

Application of Topic 606: In evaluating whether a contract with a counterparty is within the scope of ASC 606, *Revenue from Contracts with Customers,* entities must determine whether the counterparty meets the definition of a customer.[17] The definition of a customer includes the term "ordinary activities." In BC53 of ASU 2014-09 *Revenue from Contracts with Customers (ASC 606)*, the Board explained that it did not clarify the meaning of ordinary activities because the concept of ordinary activities was derived from the revenues definition in CON 6. Consequently, many entities rely on the revenues definition in CON 6 when determining whether a counterparty meets the definition of a customer. CCR is concerned that interpreting ordinary activities may therefore become more challenging if the revenues definition is modified as proposed. For example, interpreting ordinary activities is particularly difficult in many collaborative arrangements in which significant judgment is required to determine whether a collaborator meets the definition of a customer. In such instances, CCR expects the removal of "ongoing major or central operations" to increase not only diversity in practice, but also the cost and complexity of making these judgments.

New Business Models: Many entities regularly develop and cycle through experimental business models to determine the viability of the models before scaling operations. The term "major ongoing or central operations" is helpful in determining whether income and costs from these experimental business models may be excluded from margin information. CCR is concerned that without the distinction of "ongoing major or central operations," the proposed revenues definition could potentially change practice, whereby preparers classify more sources of income, such as all income from experimental business models, as revenue. This change in practice could place an unnecessary burden on preparers to implement additional systems and enhanced controls around immaterial sources of income previously not subject to the same control requirements as income included in the revenues line item. In the absence of clarifying standards-level guidance, diversity in practice is likely to follow, reducing the comparability of financial statements and creating confusion among users as to what income is attributable to core operations.

Insufficient Clarification in the Proposal

Although the proposal includes several examples that seek to distinguish revenues from gains and expenses from losses, CCR does not believe that these examples are effective, clear, or accurate. The following two paragraphs cite two such examples.

Nature of an Entity: CCR observes that the discussion in paragraph E90 attempts to relate the nature of an entity to whether a particular transaction results in revenue or a gain. Although contrasting examples are presented, these examples in no way refer to the elements definitions, nor do they clearly articulate what

[17] A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration (ASC 606-10-15-3).

the distinguishing factor is between the two scenarios. CCR believes that explanatory language, although important, should typically be based upon principles found within the elements definitions themselves. If the definitions lack foundational components upon which explanatory language can build, the definitions become unhelpful, unreliable, and more difficult to apply to areas of judgment. Therefore, CCR recommends that the Board connect the discussion in paragraph E90 to components of the respective elements definitions, which will likely require adjustments to the proposed definitions for revenues, expenses, gains, and losses if the definitions in CON 6 are not retained.

Frequency of Transaction: In paragraph E91, the Board asserts that "gains and losses in similar amounts would not be expected to reoccur frequently or at all." CCR believes this assertion does not agree with many examples in practice in which specific gains and losses can occur both frequently and for extended periods of time. For example, sublease income is often excluded from revenue because the purpose of the sublease may be solely to recover costs rather than to generate a profit, to comply with local regulations, or to maintain good business relationships by not early terminating a lease. Income from these lease transactions may persist for years in some instances when a lessee is unable or unwilling to terminate a long-term lease contract and has no alternative use for the leased space. Without the term "ongoing major or central operations" in the revenues definition, entities may interpret the guidance in paragraph E91, which relates revenues to frequency of occurrence rather than to core business operations, as requiring income from these types of subleases to be classified as revenue. Applying paragraph E91 in this way may confuse users of financial statements when, for example, subleases meant to offset unavoidable costs have a dilutive effect on margin information unrelated to an entity's core operations.

Presentation Issues

At a conceptual level, CCR believes that the elements discussion around distinguishing revenues from gains and expenses from losses is necessary and widely used in practice and should not be excluded merely because such distinctions are also matters of presentation.

At a standards level, CCR agrees with Ms. Botosan that distinguishing between revenues and gains may more appropriately be resolved in standards-level gross versus net presentation guidance; however, the current lack of presentation and classification guidance often results in inconsistent financial statement presentation even within the same industry. For example, one consumer products entity may classify warehousing costs as cost of sales, while another may classify the costs as operating overhead. Likewise, one manufacturer may classify the recovery of unavoidable costs (for example, through a sublease) as an offset to related costs, while another may recognize similar cash inflows as a gain within other income. Although outside the scope of this project, CCR recommends additional presentation and classification standards-level guidance as the most effective means to resolve such diversity in practice. Some CCR members specifically mentioned that more robust definitions for various expense categories (e.g., cost of sales; selling, general, and administrative expenses; etc.) would be particularly helpful.

Appendix A

CCR does not oppose including Appendix A in Chapter 4 of the Conceptual Framework. The concepts contained within Appendix A may aid in understanding the current accounting environment and provide context for certain terms that have traditionally been used in accounting literature. However, CCR notes that the statement, "Accrual is concerned with expected future cash receipts and payments" may cause confusion if "expected" is equated with "probable," which the Board is proposing to remove from the asset and liability definitions to eliminate confusion about probable's intended meaning.

Committee on Corporate Reporting

Conclusion

CCR appreciates the Board's effort to obtain input from stakeholders on the proposed Statement of Financial Accounting Concepts, and CCR stands ready to assist the Board in this effort.

Sincerely,

Prat Bhatt

Prat Bhatt
Chairman, Committee on Corporate Reporting
Financial Executives International