accounting
literacy
foundation

Submission to the Financial Accounting Standards Board

November 13, 2020

Thank you for the opportunity of responding to the call for comment on the proposed Statement of Financial Accounting Concepts.

We are an organization promoting accounting literacy which we believe should sit alongside reading, writing and arithmetic as a fundamental life skill. This belief comes in part because of new teaching approaches that make full comprehension of how accounting works much more accessible, and therefore ubiquity of accounting literacy possible.

One such new teaching approach and educational technology is concept mapping. An example of a concept map is appended to this submission.

The Foundation is growing and currently represents over 200 educators and other stakeholders who have been working with new teaching approaches for the last twenty-plus years.

These two decades of research and development have

- seen breakthrough learning results for tens of thousands of students in businesses, colleges and high schools
- required us to deeply consider how to present the elements and fundamental concept of accounting, and
- led us to believe that some of the constructs of the current Concept Framework are flawed.

KEY RECOMMENDATION

We believe that there are sufficient incongruities and contradictions in the current Conceptual Framework that a process of standing-back and reassessing the full Framework is warranted. In computer program analogy, a 'version 2" is warranted, not a "version 1.1".

If the board is willing to convene a conference or working group to consider a fundamental reassessment of Concept Statement 6, we would like to participate in the process. We list below a sample of areas of concern. They do not constitute a full critique of the concept framework, but are intended to persuade the Board that a fresh and more fundamental look at the framework is warranted.

Listed below are a sample of the concerns and incongruities that we are troubled by.

EQUITY AND THE POINT OF VIEW ERROR

Paragraphs E65 and E68 of the Exposure Draft state that equity is an “interest”. A plain-English understanding of the term “interest” implies that the interest is a right, and suggests it is valuable. Equity cannot be a right, nor can it be valuable. To suggest it can be a right or can be valuable is an error of point of view. Only assets are valuable. Equity is not an asset.

Equity is an obligation … more specifically, an obligation to shareholders. It is a residual obligation to funders (liabilities being the priority obligation to funders).

From the point of view of shareholders, equity is valuable. But then it is no longer equity. In the hands of shareholders, their equity-type investment is an asset. The Statement of Financial Accounting Concepts makes this shareholder-instead-of-reporting-entity point of view error.

The business entity has rights to assets, which rights are described in the balance sheet as assets. That is, interests and rights are on the other side of the accounting equation from liabilities and equity.

The interest in the assets cannot be described twice, as that would be a duplication. The rights to the assets of the business are not in both the assets element and the equity element.

Furthermore, if equity is an interest, then where on the balance sheet is the obligation to the shareholders described. For surely there (a) must be an obligation to shareholders, and (b) equity cannot be both an obligation and an interest. Ontologically those two things are opposites.

Accounting Equation
The simplest form of the accounting equation is:

Rights = Obligations
or
Assets = Obligations

Appreciating this and correctly reflecting this truth is profoundly critical to accounting education and simplifying how accounting is presented to society. It is essential that the Board and the new concept framework appreciates this.

Not appreciating this truth will mean that the entire edifice of accounting education, financial literacy, investor communication, etc. will be built on an unsound foundation.

Paragraph E5 of the Exposure Draft says that "equity is assets minus liabilities". This cannot be. The statement is confusing the quantum of equity (how it is calculated) with the nature of equity. An ontological inquiry quickly reveals that what equity IS, is an obligation.

ASSETS

The definition of "asset" is over complicated. A simplification of the term asset will go a long way to assisting investors, and people generally, to understanding accounting better.

An asset is anything that is valuable. That is, able to have value, as in value-able.

To support this definition, consider that none of the other accounting elements are valuable. Neither liabilities nor equity, revenue or expenses are valuable. Only assets can be valuable.

The quantum of the value, and the recognition criteria such as control and measurability, are all subordinate considerations arising after the definition.

The accounting equation as described above should, with exquisite symmetry and simplicity provide us with the definition of value and assets.

Assets can eliminate obligations.
Obligations can eliminate assets.

The net worth of any entity is zero. This is an underappreciated fact, disguised by the casual reference we so often make to the net worth of a business being equivalent to its equity. That is of course the net worth of the business TO ITS SHAREHOLDERS. And similarly, the net worth of a business to its creditors is the amount of its liabilities.

REVENUES AND EXPENSES

The Statement of Financial Accounting Concepts should deliberately NOT refer to "flows". This does enormous damage by perpetuating the common confusion that revenue and expenses are cash flows, in and out.

Revenues are not inflows, and expenses are not outflows.

Taking a cue from the synonymous name for the income statement, the Statement of Activities, we believe the public are strongly served by appreciating that revenue and expenses are ACTIVITIES. The Statement of Activities by definition describes activities – and, more specifically, value-sacrificing activities and value-generating activities.

We find in our teaching that it is tremendously useful to have people think of revenue and expense as verb-concepts, rather than noun-concepts.

More thoroughly:

- Revenue is any activity that increases assets or decreases liabilities to the benefit of shareholders.

- Expenses are any activity that decreases assets or increases liabilities to the detriment of shareholders.

FEWER ELEMENTS

We, like Ms Botosan in BC4.53, believe that in the quest for simplicity, the concept of gain and loss should not be separately defined from revenue and expense (or other catchall terms).

We are also concerned that outside of America the term "income" means revenue, whereas it is not defined in the US (notwithstanding "comprehensive income").

We believe that in a global and interconnected world, such fundamental terms should be aligned (particularly with the IASB's concept framework). It also seems to be a nonsense that in the US, income and net-income are synonymous and both imply "profit". To further add to the confusion, terms like "interest income" and "rental income" do not imply profit, but rather suggest "interest revenue" and "rental revenue".

The Statement of Financial Accounting Concepts presents an important opportunity to tidy up the language of accounting and finance which, in its current state, contributes to the confusion that the public experiences around accounting and reporting matters.

ADDITIONAL READING

The ideas included in the submission are described in the recently published book *The Joy of Accounting: A Game-Changing Approach That Makes Accounting Easy* (ISBN 9781735312927) We invite the board to consider the explanations in that book, which are fuller than the points expounded above.

SUBMITTED BY:
Accounting Literacy Foundation
1622 Swann St NW
Washington DC 20009
Email mark@accountingliteracy.org

CONCEPT MAP OF ACCOUNTING