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Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: June 2006, London
Project: Conceptual Framework Project Update (including definitions of assets and liabilities) (Agenda Paper 9)

INTRODUCTION

The Conceptual Framework Project

1. The Conceptual Framework project is a joint project between the International Accounting Standards Board and Financial Accounting Standards Board (the Boards) to develop an improved and common conceptual framework. The project has been divided into eight phases of which the Boards are actively deliberating Elements and Recognition - Phase B and Reporting Entity - Phase D. The Boards have also discussed the work plan for Measurement - Phase C and will shortly issue a document for comment on the Objectives and Qualitative Characteristics – Phase A.

The Purpose of this Paper

2. This paper provides an update on the Conceptual Framework project as a whole. In particular, the paper outlines the Boards' deliberations on the proposed definition of an asset, including the consideration of the comments and concerns raised by SAC members at the February 2006 meeting, and on the definition of a liability. A separate paper (Agenda Paper 9A) provides an overview of the plan for the Measurement Phase.
3. During the June 2006 session, we will solicit your input on the revised working definitions of an asset and a liability, as well as the plan for the measurement phase of the project and on the project as a whole.

Structure of the Paper

4. For the February 2006 SAC meeting, Agenda Paper 4 outlined the objective of the Joint Conceptual Framework Project, the project plan and the decisions made to that date. The remainder of this paper is a summary of the progress made since that date.

PROJECT UPDATE

Objective and Qualitative Characteristics — Phase A

5. The IASB and FASB (the Boards) have balloted a revised version of the *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information*. In June 2006, the document will be issued as *Preliminary Views* for a 120-day comment period. While there have been many drafting changes to the objectives and qualitative characteristics discussed by the SAC in February 2006, the fundamental conclusions remain unchanged.

Elements and Recognition — Phase B

Proposed Definition of an Asset

6. At the February 2006 meeting, SAC members discussed the key part of what was then proposed as the working definition of an asset:

“an asset of an entity is a present right, or other present privilege, of the entity to a resource that is capable of generating economic benefits to the entity, either directly or indirectly.”

SAC members provided the Board with comments and concerns¹ regarding this proposal, of which some have already been considered by the Boards.

7. In April 2006, the Boards continued discussing how to improve the definition of an asset by assessing a revised working definition of an asset, including proposed amplifying text. The amplifying text is being developed to communicate clearly the concepts in the asset definition, such as economic resource, rights and other privileges and how the consideration of a past event might provide evidence that the item is an asset. The revised working definition has been restructured to focus on the key concepts as follows:

An *asset* is a present economic resource of an entity.

An asset of an entity has three essential characteristics:

- (a) There is an economic resource.
 - (b) The entity has rights or other privileged access to the economic resource.
 - (c) The economic resource and the rights or other privileged access both exist at the financial statement date.
8. During discussions of the revised working definition, Board members raised several concerns including:
 - (a) The need for a better understanding of what constitutes an *economic resource*.
 - (b) The question of whether the asset is the economic resource or the right.
 - (c) The contention that the proposed definition of an asset would result in an entity's own shares being an asset. The Boards objected to this conclusion and requested that staff consider the need to modify the definition to avoid this result.
 9. Board members' concerns arose, primarily, in the context of assets established by contract. Accordingly, in June 2006,² the Boards will consider the staff's proposal to use the essential components of a contract as a framework to evaluate the concerns. For an asset created by

¹ Refer to the Minutes of the February 2006 SAC meeting for a list of the comments and concerns raised by SAC members.

² The Boards are meeting to deliberate this proposal the week prior to the SAC meeting; accordingly, staff will provide an update on the results of those deliberations at the SAC meeting.

contract, the economic resource is the promise that the reporting entity has a legally enforceable³ right to receive and benefit from. A promise is created when an external counter-party (the promisor) commits to take a required action (or inaction) for the reporting entity (the promise). The asset itself is established as a result of the existence of both the promise and the reporting entity's right to the promise. Staff also propose that an entity's own shares do not meet the definition of an asset since, with no external counter-party there is no economic resource.

10. The remaining comments and concerns raised by SAC members will be considered by the Boards when they review the revised working definition of an asset, together with proposed amplifying text and examples illustrating their application in July 2006. The examples to be considered will include goodwill and other types of intangibles. The Boards will also evaluate whether the proposed working definition is an improvement on the existing definition, including assessing the understandability of the concepts and terminology in English and other languages.

Proposed Definition of a Liability

11. In April 2006, the Boards continued discussing a proposed definition of a liability, including proposed amplifying text. The Boards also considered the proposed definition of a liability in conjunction with the definition of an asset to evaluate the similar aspects of the two definitions to identify where symmetry is desirable. The following is the proposed working definition of a liability:

A liability is a present economic obligation of an entity.

A liability of an entity has three essential characteristics:

- (a) The obligation is economic—it requires the entity to provide or stand ready to provide its economic resources to others, or to forgo economic resources that it might otherwise be able to obtain.
- (b) The entity is obligated to others to act or perform in a certain way (or refrain from acting or performing).
- (c) The economic obligation and the legal enforceability (or its equivalent) both exist at the financial statement date.

³ Economic resources may also arise from promises that are not legally binding but are equivalently enforceable.

12. In July 2006, the Boards will review the revised working definition of a liability together with amplifying text and examples illustrating their application. The Boards will also evaluate whether the proposed working definition is an improvement on the existing definition.

Other Aspects of Phase B

13. This Phase of the project will also include consideration of unit of account issues, the distinction between liabilities and equity, other elements and recognition and derecognition criteria. Discussions of these topics will commence in September and October 2006. A Preliminary Views document on Phase B is tentatively scheduled for issuance in the second quarter of 2007.

Measurement — Phase C

14. In April 2006, the Boards discussed the plan for the Measurement Phase (see separate Agenda Paper 9A for the SAC meeting). The comments received on the Canadian paper, *Measurement Bases for Financial Reporting: Measurement on Initial Recognition*, will comprise input to this Phase of the project. A preliminary analysis is scheduled to be presented to the IASB in July 2006, with a full analysis for both the IASB and FASB in September 2006.

Reporting Entity — Phase D

15. At the March and April, 2006, the Boards discussed (a) the meaning of the term entity, (b) whether a parent-only entity may be the subject of general purpose external financial reporting, and (c) the meaning of control, in the context of one entity having control over another entity. At those meetings, the Boards reached the following conclusions:

- (a) An entity for financial reporting purposes should not be limited to legal entities, such as companies, trusts, and partnerships. Rather, an entity should be defined more broadly to include other types of organizational structures, including a natural person, a sole proprietorship, and, in some circumstances, a branch or segment of a legal entity.

(b) A parent-only entity could be a reporting entity. Board members, however, reached this conclusion differently:

- (i) Some Board members reached that conclusion by viewing the parent-only entity and a group entity as different entities. Those Board members regard the (a) separate (parent-only) financial statements of the parent as a stand-alone entity (for example, a parent with its investments in subsidiaries but excluding the assets, liabilities, and activities of its subsidiaries) as relating to the parent-only entity and (b) consolidated financial statements of the parent and its subsidiaries as relating to a group entity that combines the parent with one or more other entities, as if they were a single entity.
- (ii) Other Board members reached that conclusion by viewing the parent-only financial statements and the consolidated financial statements as different forms of presentation of the same entity.

(c) Control, in the context of one entity having control over another entity, should be defined at the conceptual level. The Boards agreed with the staff proposal that the definition of control should contain both a *power* element and a *benefits* element, with a link between these two elements. The *power* element should refer to the entity's ability to direct the operating and financing policies of another entity and the *benefits* element should refer broadly to benefits or economic benefits with no specification as to a minimum level of benefits. The Boards also offered suggestions for improving the definition.

16. Discussions on this phase of the project are expected to continue in September 2006. A Preliminary Views document is tentatively scheduled for issuance in the second quarter of 2007.