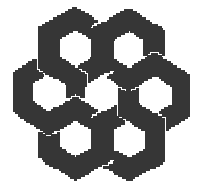


This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

INFORMATION FOR OBSERVERS

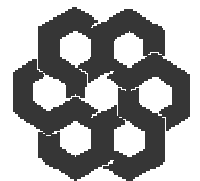
SAC Meeting: February 2006, London
Project: Conceptual Frameworks
(Agenda Paper 4C)



CONCEPTUAL FRAMEWORKS

James J. Leisenring

Member: International Accounting
Standards Board



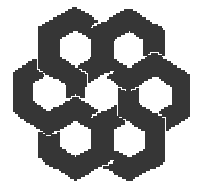
CONCEPTUAL FRAMEWORKS

The FASB concluded in Concepts Statement No. 1:

“. . . Financial reporting should provide information to help investors, creditors, and others assess the amount, timing, and uncertainty of prospective net cash inflows to the related enterprise.” *paragraph 39*

The IASB framework:

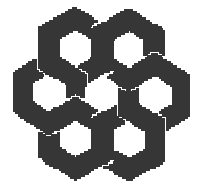
“The economic decisions that are taken by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation.” *paragraph 15*



CONCEPTUAL FRAMEWORKS

“The primary focus of financial reporting is information about an enterprise’s performance provided by measures of earnings and its components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information.”

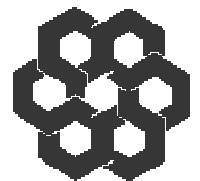
FASB Concepts Statement 1, paragraph 43



CONCEPTUAL FRAMEWORKS

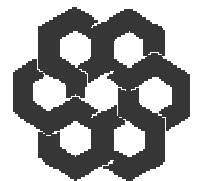
Furthermore, the Board said, “Information about enterprise earnings and its components measured by accrual accounting generally provides a better indication of enterprise performance than information about current cash receipts and payments.”

FASB Concepts Statement 1, paragraph 44



CONCEPTUAL FRAMEWORKS

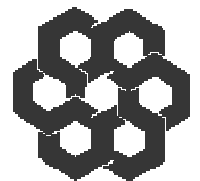
- Accepting these conclusions focuses the debate on the items to be recognized in accrual basis earnings (profit and loss) and the measurement of those items.
- The fundamental nature of most accounting debates is that we don't agree on what should be considered earnings or profit and loss.



CONCEPTUAL FRAMEWORKS

Source of the Early Debates

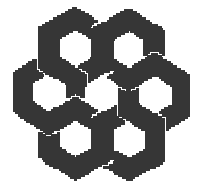
- Assets, liabilities, or “what-you-may-call-its”
- Proper matching to avoid “distorting” periodic earnings
- Argument often used to avoid recognition of an item is that the result will “distort” earnings (profit and loss)
- Argument often also used to recognize an item to avoid “distortion” of income



CONCEPTUAL FRAMEWORKS

APB STATEMENT NO. 4—ASSETS

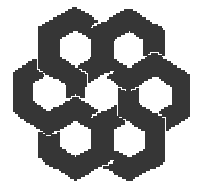
- *Assets*—economic resources of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Assets also include certain deferred charges that are not resources but that are recognized and measured in conformity with generally accepted accounting principles.



CONCEPTUAL FRAMEWORKS

APB STATEMENT NO. 4—LIABILITIES

- *Liabilities*—economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Liabilities also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles.

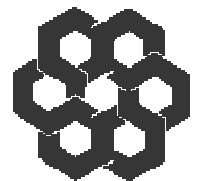


CONCEPTUAL FRAMEWORKS

Asset

“An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.”

IASB Framework, paragraph 49(a)

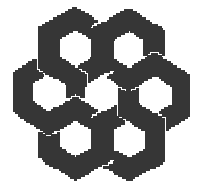


CONCEPTUAL FRAMEWORKS

Liability

“A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.”

IASB Framework, paragraph 49(b)

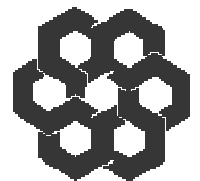


CONCEPTUAL FRAMEWORKS

Income

“Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.”

IASB Framework, paragraph 70(a)

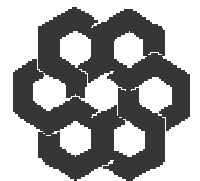


CONCEPTUAL FRAMEWORKS

Expenses

“Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.”

IASB Framework, paragraph 70(b)

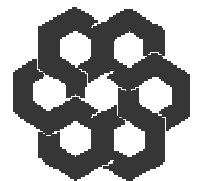


CONCEPTUAL FRAMEWORKS

IASB Framework

“Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.”

IASB Framework, paragraph 94

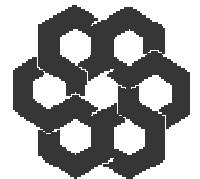


CONCEPTUAL FRAMEWORKS

IASB Framework

“. . . The application of the matching concept under this *Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.”

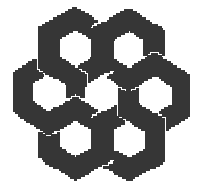
IASB Framework, paragraph 95



CONCEPTUAL FRAMEWORKS

IASB and FASB Framework

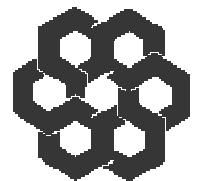
- Basic conclusion as to the conceptual primacy of assets and secondarily liabilities
- Said by some to be a “balance sheet” approach
- Can there be an “income statement” view?



CONCEPTUAL FRAMEWORKS

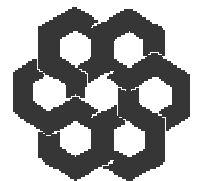
The clear answer to the question is NO.

- Can't define revenues, expenses, gains and losses without reference to assets
- Absent independent definition of revenues, expenses, gains and losses (not dependent on assets and liabilities), the income statement view is vacuous
- Measuring net income by the change in net assets provides an anchor for resolving difficult accounting questions



CONCEPTUAL FRAMEWORKS

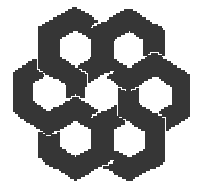
- SEC study on principles-based standards states:
“the revenue/expense view is inappropriate for use in standard-setting ...Historical experience suggests that the asset/liability approach most appropriately anchors the standard-setting process by providing the strongest conceptual mapping to the underlying economic reality” (p. 30)
“the FASB should maintain the asset/liability view” (p. 42)



CONCEPTUAL FRAMEWORKS

Examples of Issues with Definitions

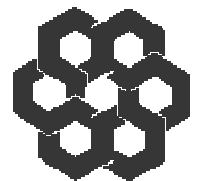
- Control in *assets* definition: When two parties seem to have some control over the same asset (e.g., assets subject to call options or forward purchase contracts)
- Obligating event in *liabilities* definition: When obligations result from a series of events, which event is *the* obligating event



CONCEPTUAL FRAMEWORKS

Convergence Issues with Definitions

- Is the asset the resource or the future benefit from the resource?
- Is the liability the present obligation or the future sacrifice to satisfy the obligation?
- *Probable* is in the FASB's definitions (but not its recognition criteria) and in the IASB's recognition criteria (but not its definitions)—and the meaning is different



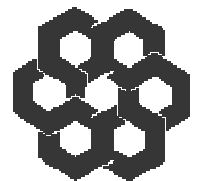
CONCEPTUAL FRAMEWORKS

Recognition

Similarities in recognition criteria:

In both frameworks, an item must:

- Meet the definition of an element (*asset, liability, etc.*)
- Have a cost or value (measurement attribute) that can be measured with sufficient reliability (thus, timing of recognition may depend on the attribute being measured)

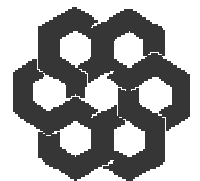


CONCEPTUAL FRAMEWORKS

Recognition

Differences in recognition criteria:

- IASB: *Probable* that benefit will flow to or from the entity (FASB does not include *probability* criterion)
- FASB: Item must be *relevant* & measurement attribute must be *relevant* (IASB does not include *relevance* as a criterion or as a qualifier of measurement attribute criterion)

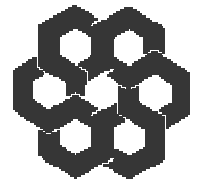


CONCEPTUAL FRAMEWORKS

Recognition

Other issues:

- Neither framework discusses *derecognition* (removal of previously recognized item from financial statements)
- However, both IASB & FASB standards on financial instruments (IAS 39 & FAS 140) require *other things* to occur for financial assets to be derecognized (and *different* other things to occur before liabilities can be derecognized)

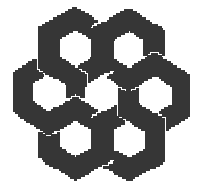


CONCEPTUAL FRAMEWORKS

Recognition

In summary, the Boards will need to:

- Revise recognition criteria to eliminate the present differences in them (*probability* criterion & *relevance* criterion)
- Provide a basis for resolving issues such as *derecognition*



CONCEPTUAL FRAMEWORKS

Recognition

Fundamental Questions

- Should *anything* that meets the definition of an asset or liability of an entity fail to be reported?
Recognized?
- Is a definition of equity necessary or is it always just the difference between assets and liabilities?

