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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IASB Meeting:	**26 April 2006, London**
Project:	**Conceptual Framework: Elements 4: Asset Definition (III) & Liability Definition (II) (Agenda Paper 8A)** (This observer note is also issued for Agenda Paper 5 at the Joint IASB/FASB Meeting)

INTRODUCTION

1. This paper continues discussion of the *elements* phase of the joint IASB/FASB conceptual framework project. It proposes working definitions of an asset and a liability, together with amplifying text, and requests that the Boards determine which form(s) of the definitions we should move forward with, together with amplifying text, to test against examples in June 2006[1] and to consider other aspects of Phase B of the conceptual framework project.[2]

2. In December 2005, the Boards considered similarities and differences between the definitions of an asset that are presently contained in the IASB *Framework for the Preparation and Presentation of Financial Statements* (IASB *Framework*) and FASB Concepts Statement No. 6, *Elements of Financial Statements*, (CON 6), as well as

[1] We have been considering the definitions relative to a number of examples as we have been developing them. However, once the Boards determine which of the definitions to go forward with we plan to bring forward a paper that illustrates the application of the definitions to a range of examples, to ensure that the definitions work for the most obvious situations as well as those demonstrating issues at the margins.

[2] The definitions might be further modified as this phase of the project moves forward. However, we believe that we need to reach conclusions on them as a working draft at this time, so that we can move forward, rather than running the risk of over-engineering this material at this time.

differing aspects of definitions of an asset in the conceptual frameworks of other standard setters. The Boards also considered whether the definition of an asset for financial reporting purposes should differ from the general usage of the term and whether a distinction should be made between assets that are recognized and assets that are not recognized. Finally, the Boards considered the essential characteristics of an asset and a proposed working definition.

3. In February 2006, the Boards undertook a similar consideration of the definition of a liability and further considered the working definition of an asset. A summary of tentative conclusions reached by the Boards in February is in Appendix A to this paper.

4. This paper draws together conclusions based on the previous Boards' discussions and proposes working definitions and amplifying text. The paper considers proposed working definitions of assets and liabilities together, so as to be able to evaluate those aspects of the two definitions where symmetry is desirable. The paper considers matters in the following order:

   a. Proposed working definitions of an asset and a liability (paragraphs 6-7)

   b. Working draft of amplifying text for conceptual framework (paragraphs 8-77)

      (1) Assets (paragraphs 14-48)

      (2) Liabilities (paragraphs 49-79)

   c. Comparison of proposed definitions with existing definitions (paragraphs 80-88)

   d. Comparison of proposed definitions with those presented in February 2006 (paragraphs 89-93).

   Appendices provide:

   Appendix A: Summary of tentative decisions reached in February 2006

   Appendix B: Current status of cross-cutting issues

   Appendix C: Existing definitions of the IASB, FASB, national accounting standards setters, and others

5. This paper does not consider options over assets, which is scheduled for discussion later in 2006. Also, the paper assumes that we know what item we are evaluating to assess whether it is an asset—that we can identify what the boundaries of the item are—that is, that we know the unit of account. (This is, of course, a broad assumption, given the issues

that need to be addressed in considering what the unit of account is, which will be discussed later in 2006.) In addition, this paper does not consider when an asset should be recognized. Recognition is a separate topic scheduled for discussion later in 2006. Therefore, conclusions reached as to what meets the definition of an asset do not necessarily mean that all assets (as defined) will be recognized in financial statements.[3]

Proposed Working Definitions of an Asset and a Liability

6. We have considered a number of possible working definitions of an asset and a liability. The following table summarizes what we believe are the best candidates. The first four candidates (A-D) are variations on one another, building more or less detail into the definition or changing the order of the words. In all cases, when less detail is included in the definition, corresponding amplification would be included in amplifying text. The three essential characteristics of assets and of liabilities, included in the amplifying text should be considered integral to the definition. The fifth candidate (E) seeks to minimize the extent of change from existing definitions of an asset and a liability. However, even this candidate is really just a variation on the others. Our recommendation is highlighted in bold—candidate A. It is that candidate on which the working draft of amplifying text in the next section of this paper has been developed.[4]

<table>
<tr><th>Asset Definition</th><th>Liability Definition</th></tr>
<tr><td>A. An asset is a present economic resource of an entity.</td><td>A. A liability is a present economic obligation of an entity.</td></tr>
<tr><td colspan="2">This pair of definitions represents the most basic form. These leave the bulk of the explanation to the amplifying text. They also seek to avoid difficulties that arise when we attempt to include new ideas in the definition using words that either stretch their common meaning, or require additional explanation to understand their meaning.</td></tr>
<tr><td>B. An asset of an entity is its present right to an economic resource.</td><td>B. A liability of an entity is its present obligation to provide its economic resources to others.</td></tr>
<tr><td colspan="2">This pair of definitions adds some additional information—in the case of an asset, it adds the fact that the entity is associated with the asset by virtue of having a present right. [Two sentences omitted from Observer Notes] The corresponding definition of a liability spells out that an “economic obligation” is an “obligation to provide its economic resources to others.”</td></tr>
<tr><td>C. An asset of an entity is its present right or other privileged access to an economic resource.</td><td>C. A liability of an entity is its present obligation to provide its economic resources to others.</td></tr>
<tr><td colspan="2">Only the definition of an asset is changed in this pair—to specify in the definition, rather than</td></tr>
</table>

[3] [Footnote omitted from Observer Notes]

[4] Should the Boards prefer a different alternative, much of the amplifying text would be unaffected in substance, although its order and emphasis might change.

in amplifying text, that it is not only a present right that might associate an asset with an entity, but also "other privileged access." Amplifying text would continue to be necessary to explain what we mean by "other privileged access."	
D. An *asset* of an entity is a present economic resource to which the entity has a present right (or other privileged access).	D. A *liability* of an entity is an outflow of its economic resources for which the entity has a present obligation.
This pair of definitions change the order of the words compared to candidates B and C, to emphasize that an asset might be the economic resource itself (e.g., inventory, or land), in addition to circumstances when the resources are the entity's rights. (This structure could be used with or without the reference to "other privileged access".) The corresponding definition of a liability seeks to achieve a parallel wording structure. [Final sentence omitted from Observer Notes]	
E. An *asset* is a present resource of an entity from which future economic benefits could flow to the entity.	E. A *liability* is a present obligation of an entity which could result in an outflow of resources embodying economic benefits.
This pair of definitions minimizes wording changes from existing definitions—essentially, removing from the existing definitions[5] references to: (a) past transactions and events, (b) probability, and (c) control and then conforming the wording between the existing IASB and FASB definitions. [Two sentences omitted from Observer Notes]	

7. We recommend candidate A. [Remainder of paragraph omitted from Observer Notes]

Working Draft of Amplifying Text for Conceptual Framework

8. The following paragraphs set out a working draft of amplifying text for a conceptual framework document to support the definitions of an asset and a liability. The working draft is based on candidate A in paragraph 6. However, it could be appropriately modified to fit any of the other candidates should the Boards decide that they prefer an alternative other than candidate A.

Background

9. Elements of financial statements are the building blocks with which financial statements are constructed—the classes of items that financial statements comprise. The elements directly related to the financial position of an entity at a point in time are assets, liabilities, and equity.[6]

10. Definitions of elements of financial statements are a significant first screen in determining the content of financial statements. An item's having the essential characteristics of an

[5] Appropriate amplifying text, similar to that outlined in the next section of this paper, would continue to explain these aspects.

[6] We commence consideration of equity in a separate paper for the Boards' April meetings. We plan to consider other elements, such as revenues and expenses, at a meeting later in 2006.

element is a necessary, but not a sufficient, condition for recognizing the item in an entity's financial statements. To be included in a particular set of financial statements, an item must not only meet the definition of an element, but also must meet criteria for recognition and measurement.[7]

11. All elements are defined in relation to a particular entity, which may be a business entity, a not-for-profit entity (such as an educational or charitable organization), a natural person, or the like. An item that meets the definitions is a particular entity's asset, liability, revenue, expense, or so forth. The amplifying text supporting the definitions refers to *others*, which include individuals, business entities, not-for-profit entities, and the like. For example, employees, suppliers, customers or beneficiaries, lenders, shareholders, donors, and governments are all *others* to a particular entity. A subsidiary company that is part of the same entity as its parent company in consolidated financial statements is an "other" in the separate financial statements of its parent. *Others* may be individuals or a class of persons.

12. Most elements will appear only in one entity's financial statements (although a particular element might appear in both separate and consolidated group financial statements). An exception is when two or more entities are "jointly and severally liable."

13. In order to have a liability, another party must have an asset. However, the reverse does not hold true as some assets are established by property rights, and for other assets the other party might have issued equity.

Definition of an Asset

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

15. An asset of an entity has three essential characteristics:

    a. There is an underlying economic resource

    b. The entity has rights or other privileged access to the economic resource

    c. The rights or other privileged access exist at the financial statement date.

An Economic Resource

[7] Criteria for recognition and measurement will be considered later in this project.

16. The first essential characteristic of an asset is that there is an underlying economic resource. Economic resources are the scarce means that are useful for carrying out economic activities, such as consumption, production, and exchange. That is, they are resources that are economically beneficial. Economic resources include inventory, plant, equipment, mineral deposits, patents and similar intangibles, goodwill, services, cash, claims to cash, and ownership interest in other entities. In some instances, contractual rights might be economic resources (see paragraph 21).

17. A resource is economically beneficial if it can be exchanged for something else that is economically beneficial, used to produce something economically beneficial, or used to settle liabilities. In a business entity in the private sector, a resource is economically beneficial if it eventually results in cash inflows to the entity or a reduction in cash outflows from the entity. The relationship between economic benefit and cash flows is often indirect and may arise from a single resource, or from a combination of resources. As explained in Chapter 1: *The Objective of Financial Reporting*, of the February 22, 2006 draft of the Conceptual Framework for Financial Reporting:

> …some of an entity's economic resources, such as accounts or notes receivable, are direct sources of future cash inflows... However, many of the cash flows generated by a business entity's operations result from combining several of its economic resources to produce or provide and market goods or services. Although those cash flows cannot be identified with individual economic resources…, investors and creditors need to know the nature and quantity of the resources available for use in a business entity's operations…[8]

18. The most obvious evidence of an economic resource is that it has a market price (although the lack of a market price does not preclude a resource from being an asset). Anything that is commonly bought and sold is economically beneficial, including the individual resources that a buyer obtains and is willing to pay for in a "basket" purchase of several items at the same time or in a business combination. Similarly, anything that creditors commonly accept in settlement of liabilities is economically beneficial, and anything that is commonly used to produce goods or services, whether tangible or intangible and whether or not it has a market price or is otherwise exchangeable, is also economically beneficial.

19. As long as there is a non-zero probability or expectation of economic benefit to the entity at the financial statement date, then the entity has an economic resource.

[8] [Footnote omitted from Observer Notes]

Rights or Other Privileged Access to an Economic Resource

20. The second essential characteristic of an asset is that the entity has rights or other privileged access to the economic resource. The assets that are useful for financial reporting purposes are those that are relevant to users' decisions about a particular entity. Therefore, the definition focuses on assets "of an entity". An entity's association with economic resources is established by virtue of it having rights or other privileged access to those resources.

21. An asset of an entity might be represented by property rights to an economic resource (such as the right to possess, use and enjoy a parcel of land) or by rights or other privileged access to some or all of the economic benefits derived from an underlying economic resource.[9] For example, in the case of a contract presently held to buy next year's corn crop, the asset of an entity holding that contract is not the corn to be grown and harvested next year; rather it is the contractual right to the economic benefits to be derived from the corn crop. Until the corn is harvested, the only present economic resource of the entity is the *right* to the economic benefits to be derived from the corn crop (economic benefits may exist because the price of corn has risen above the contract price). The asset presently represented by the contractual right will be replaced by the property rights to the physical resource, that of the corn, when the corn is harvested. At this time, it is the corn itself that constitutes the economic resource. In the case of property rights, there is no corresponding obligation of another party. However, for most other rights another party has a corresponding obligation.

22. Rights can be obtained in various ways. Often they are obtained by legal ownership of the underlying item. Such ownership usually gives the owner access to a number of economic benefits, including the ability to possess, use and enjoy the resource, to sell or exchange it, or to exploit its value by, for example, pledging it as security for borrowing.

23. However, legally enforceable rights to benefits derived from an economic resource can be obtained without having legal ownership of the underlying resource, as is the case, for example, when property is leased or when an entity has rights only to cash flows arising from an underlying resource, such as in the case of a contract providing rights only to interest flows from an underlying debt instrument.

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[9] The beginning of this paragraph, and much of the next four paragraphs, is derived from the UK *Statement of Principles for Financial Reporting*, December 1999, paragraphs 4.8-4.12.

24. Other legally enforceable rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or trade mark. Thus, legally enforceable rights include, among other rights, contractual rights, rights under promissory estoppel, and property rights.

25. An entity need not have an *exclusive* right or restriction in order to have an asset. Rights and restrictions may be single (held or imposed solely by the entity) or shared (held or imposed in conjunction with others). Two or more entities might have different rights to economic benefits from the same economic resource at the same time, or might have rights to the same economic benefits at different times. For example, lease arrangements unbundle the future economic benefits embodied in leased property by giving the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value. Also, time-share property owners have the rights to use a property during specified time periods. Each entity has an asset based on the rights that it has.

26. Two or more entities might have an undivided interest in an economic resource, such as a parcel of land or mineral resources. Each has a right to economic benefits deriving from that resource that might qualify as an asset, even though the right of each is subject at least to some extent to the rights of the other(s).

27. Rights also might be enforceable by means equivalent to legal enforcement, such as those arising within a self-regulatory structure, such as a professional organization. If rights enforced by such other means are enforced similar to how rights would be legally enforced, they may be regarded as the equivalent of legally enforceable rights.

28. An entity also can obtain economic benefit from a resource in the absence of legally enforceable rights. For example, an entity might have no legally enforceable rights to secret know-how, or an unpatented invention, but can use or sell the knowledge or invention (to generate economic benefits) and restrict, or otherwise prevent or limit, others' access. Therefore, the ability to restrict others' access also creates an asset of an entity in that it creates an advantage beyond the common advantages of others—privileged access.

29. Things that give the entity no advantage beyond the common advantages of others because they are available to all do not qualify as assets. A right that is not restricted, such as a right to sue, or a right to appreciate music, is not an asset of an entity. Having a public road outside an entity's property might seem like an asset. However, as long as there are no restrictions as to who can drive on that road, then the right to drive on that

road is not an asset of the entity (although the proximity of the road might add value to the property)—there is no advantage, or privileged access, to the entity. A specific right to use a road from which a licensee might otherwise be excluded, such as a license to operate a truck on the road, may, however, be an asset of an entity if it is economically beneficial to it.

30. Every asset is an asset of some entity; moreover no asset can simultaneously be an asset of more than one entity. The entity having rights or other privileged access to an economic resource is the one that can exchange those rights or permit access, use the resource to which it has the rights to produce goods or services or reduce other expenditures, exact a price for others' use of the rights or access, use them to settle liabilities, hold them, or perhaps distribute them to owners.

31. Economic benefits from an economic resource must accrue to the entity. An asset does not include an economic resource that the entity has rights or other access to, but which generates economic benefits that only go elsewhere (for example, when the entity is merely acting as an agent for others).

The Relationship between Rights and Control

32. Control refers to the ability to direct, manage, or have power over something so as to obtain or access benefits, or to increase, maintain or protect those benefits. As noted in paragraph 21, an asset of an entity might be represented by property rights to an economic resource, or by rights or other privileged access to some or all of the economic benefits derived from an underlying economic resource that may, or may not, yet exist. What is important in the case of rights or other privileged access to some or all of the economic benefits derived from an underlying economic resource, is not necessarily whether an entity can direct, manage, or have power over the entire underlying resource; rather, it is whether it can direct, manage, or have power over the rights to the resource. Thus, a 10 per-cent interest in a resource is an asset. The entity does not control the resource—it cannot direct, manage, or have power over the entire resource. However, the entity does control the 10 per-cent interest.

33. Rights sometimes do, but often do not, give the holder the power to direct the thing it has rights over. For example, minority rights do not give power to direct the activities of an entity, nor do shared rights in a joint venture. However, to have an asset an entity must have rights to the resource, or the benefits deriving from the resource, or have the ability

to place limits on or restrict access to a resource, or benefits deriving therefrom. The role of control for assets existing other than by means of property rights is in determining whether the entity can direct, manage, or have power over the rights, limits or restrictions, which represent the economic resource.

34. Some other party's restriction that happens to also benefit the entity is not an asset of the entity unless the entity can direct, manage, or have power over the restriction. For example, an agreement entered into between team A and one of its players that precludes team A from trading the player to team B (a no-trade clause) could be considered an asset of team C—that is in competition with team B—and would, therefore, prefer that player not be traded to team B. However, team C is not a party to that restriction—it does not direct, manage, or have power over that restriction—and, hence, team C does not have an asset.

Present Rights

35. The third essential characteristic of an asset is that rights or other privileged access exist at the financial statement date. Thus, the entity must have rights or other privileged access to the economic resource at that date—i.e., it must have *present* rights. This means that the asset must have arisen from past transactions or other past events. Often assets are obtained by purchasing or producing them, but other transactions or events may generate assets. Examples include the discovery of mineral deposits and the receipt of land or buildings from a government as part of a program to encourage economic growth in an area. The means of acquiring rights or other access does not affect whether the item under consideration meets the essential characteristics of an asset at the present time, although it might provide evidence to help in the assessment as to whether the item is an asset—i.e., the history of how the asset arose does not matter.

36. Transactions or other events expected to occur in the future do not in themselves give rise to assets today. An intention to purchase inventory does not, of itself, meet the definition of an asset. Equipment to be acquired next year does not give rise to a present right to that equipment today. However, if the reporting entity has a contract to purchase equipment, it might give rise to something of economic benefit, with the ability to generate cash inflows, so that there might be an asset representing the economic benefit that could be derived from the right to acquire the equipment, rather than the equipment itself.

37. The corollary is that an entity still has an asset if the transactions or other events that ultimately use up or destroy the economic benefits associated with the resource are yet in the future. For example, an asset remains, even if the entity has decided that it will sell or stop using a resource in the future.

Other Characteristics That May Assist in Identifying an Asset

38. Assets commonly have other features that help to identify them—for example, assets may be tangible or exchangeable. However, those features are not essential characteristics of assets. Their absence is not sufficient to preclude an item from qualifying as an asset. That is, assets may be intangible, and although not exchangeable, they may be usable by the entity in producing or distributing other goods or services.[10]

Examples of Assets

39. Cash meets the definition of an asset in that cash is a medium of exchange. Cash is legal tender that can be readily tendered in exchange for other resources that are economically beneficial to the entity. For business entities in the private sector, cash is the ultimate economic resource.

40. Assets other than cash benefit an entity by being exchanged for cash or other goods or services, by being used to produce goods or services or otherwise increase the value of other assets, or being used to settle liabilities.[11]

41. Accounts and notes receivable, interest and dividends receivable, investments in shares of other entities, and similar items are claims to cash and, thus, are assets. Note that uncollectible receivables do not qualify as assets.

42. Inventories of raw materials, supplies, partially completed product, finished goods, and merchandise, property, plant, equipment, computer hardware, tools, furnishings, leasehold improvements, and mineral deposits will be used by an entity to produce cash. They too are economic resources of an entity—assets.

43. Certain intangibles, such as patents and trademarks meet the definition of an asset because the entity has contractual rights and can economically benefit from those rights—i.e., the entity has rights to an economic resource. Intangibles that are not protected by

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[10] Derived from CON 6, paragraph 26.
[11] Quoted from the first sentence of CON6, paragraph 30.

legal rights, such as an unpatented invention or an internally developed customer list, also might meet the definition if the entity can restrict others' access to the resource. Cash flows might be generated either by sale or use of the invention or customer list.

44. An option or forward contract giving an entity the right to acquire an economic resource, or an option to renew a contract on favorable terms, also is an asset. Writing an option also may result in an asset. However, in this case, the asset represents only a privilege or advantage that is economically beneficial to the option writer at the financial statement date, such as the benefit of reduced costs to access existing contract holders rather than seeking out new customers. Any asset arising from a privilege or advantage in this case must be distinguished from economic benefits arising from the anticipated renewed contracts themselves. While such benefits might affect the value of the *relationship* asset, the option writer has no present right to those economic benefits at the financial statement date and, thus, they are not an asset of the option writer at the financial statement date.

45. Services provided by other entities cannot be stored and are received and used simultaneously. They can be assets of an entity only momentarily—as the entity receives and uses them (at which point they become impounded in other assets, such as inventory, in the form of labor, or other service, costs)—although their use may create or add value to other assets of the entity. Services yet to be rendered cannot be a present economic resource. However, rights to receive services of other entities for specified or determinable future periods can be present economic resources and, thus, assets of particular entities.

46. Contracts such as a guarantee held on an amount receivable providing for a payment from the guarantor if the original debtor fails to pay, or a warranty held on an asset providing for repair or replacement of the asset if it proves defective, establish unconditional rights to economic benefits. In these instances, the holder of the warranty or guarantee has an asset, representing the unconditional right to benefit if the uncertain event that is the subject of the conditional right occurs (or fails to occur).

47. Valuation accounts—that reduce or increase the carrying amount of an asset, such as an estimate of uncollectible amounts receivable or a premium on a bond receivable—are part of the related assets and are neither assets in their own right nor liabilities.

48. Losses are not economically beneficial and cannot qualify as assets. However, an entity might derive economic benefit as a result of a loss, such as that arising from a tax loss

carried forward. In the latter case, it is the right to the economic benefit arising from the tax loss carried forward that represents the asset, rather than the loss itself.

Definition of a Liability

49. A liability is a present economic obligation of an entity.

50. A liability of an entity has three essential characteristics:

    a. The entity is obligated to act or perform in a certain way (or refrain from acting or performing)

    b. The obligation exists at the financial statement date

    c. The obligation is *economic*—it is an obligation *to provide its economic resources* to others, or to stand ready to do so.

Entity Is Obligated to Act or Perform in a Certain Way

51. The first essential characteristic of a liability is that the entity is obligated to perform or act in a certain way (or refrain from acting or performing). In the context most relevant to financial reporting, the *Oxford English Dictionary Online* defines an *obligation* as "a moral or legal tie *binding* to some performance."[12]

52. In a financial reporting context, something is "binding" on an entity if it requires performance, either legally or by equivalent external means. "Performance" is what an entity is required to do (or refrain from doing) to satisfy the obligation.

53. Most liabilities are legally enforceable. Legally enforceable obligations include those arising from binding contracts, agreements, rules, statutes, or other requirements that would be upheld by a judicial system or government, or are accepted by entities to avoid imposition by the justice system or government. Judicial systems vary as to type and form and the term includes any such system that would enforce laws, statutes and regulations.

54. An entity also might be obligated by other external means equivalent to a judicial system. Such means must be capable of enforcing an obligation similar to a legally enforceable obligation. For example, a self-regulatory body may impose and enforce requirements upon its members. If those requirements are enforced similar to how legally enforceable

[12] *Oxford English Dictionary Online*, accessed February, 2006.

obligations would be enforced, they may be regarded as the equivalent of legally enforceable obligations.

55. Entities routinely incur most liabilities in exchange transactions to acquire the funds, goods, and services they need to operate. For example, borrowing cash obligates an entity to repay the amount borrowed; acquiring assets on credit obligates an entity to pay for them; using employees' knowledge, skills, time, and efforts obligates an entity to pay for their use, often including fringe benefits; and selling products with a warranty or guarantee obligates an entity to stand ready either to pay cash or to repair or replace those that prove defective. Often, obligations incurred in exchange transactions are contractual in nature—based on written or oral agreements to pay cash or to provide goods or services to specified or determinable entities on demand, at specified or determinable dates, or on occurrence of specified events.[13]

56. Agreements, contracts or statutory requirements will often specify or imply how an obligation was incurred, and when and how the obligation is to be settled. For example, borrowing and rental agreements specify the amount of charges and the dates when payments are due. The absence of a specified maturity date or event to trigger settlement may cast doubt that an obligation exists.[14]

57. Certain obligations require nonreciprocal transfers from an entity to one or more other entities. Such obligations include income and sales taxes imposed by governments, donations pledged to charitable organizations, and cash dividends declared but not yet paid.[15]

58. Some liabilities arise from constructive obligations. A constructive obligation may be created, inferred, or construed from the facts in a particular situation, rather than contracted by agreement with another entity or imposed by government. For example, an entity may pay its employees vacation pay or year-end bonuses every year even though it is not contractually bound to do so and has not announced a policy to do so. Nonetheless, a court could construe that practice to have created a legally enforceable obligation.

59. Legal means have developed for dealing with certain injustices that might otherwise be done by business entities and others absent legislation, regulation, or contractual relationships. In common law, equity courts sometimes construe an obligation and grant

[13] Derived from CON 6, paragraph 38.
[14] Last sentence is derived from CON 6, paragraph 194.
[15] Derived from CON 6, paragraph 39.

redress in such cases. For example, the doctrine of *promissory estoppel*[16] is grounded in significant reliance on a less-than-contractual promise by the promisee rather than the explicit terms of a contract. Legally enforceable obligations therefore include such constructive obligations.

60. An equitable obligation stems from ethical or moral constraints, that is, from a duty to another entity to do that which an ordinary conscience and sense of justice would deem fair, just, and right—to do what one ought to do rather than what one is legally required to do.[17] For example, management of an entity may have an equitable obligation to complete and deliver a product to a customer that has no other source of supply even though the entity's failure to deliver would legally require only return of the customer's deposit. Management of the entity in this example is not required by means equivalent to legal enforceability to complete and deliver the product. Hence, in the absence of a further requirement to complete and deliver a product, no obligation exists beyond that to return the customer's deposit.

61. Lack of legal enforceability is not necessarily grounds to exclude an obligation as a liability. Such an obligation should be assessed as to whether another external means of enforcing the obligation exists that is the equivalent to legal enforcement. For example, in many wholesale diamond markets or other commodity markets throughout the world, exchanges are agreed upon based on oral discussions or non-verbal signals. Traders in such markets will only conduct business in that manner, with disputes settled based on the traders' mutual understanding of the transaction. Obligations created under these circumstances may not be enforceable in court, but nonetheless may be enforceable by virtue of the rules and regulations of the trading organization. Traders that do not honor such obligations might be excluded from membership and, thus, from conducting any future trades in that market, thus losing their livelihood, or be subject to other fines or penalties imposed by the regulatory body, the threat of which is sufficient to enforce performance.

62. Management of an entity might be motivated to provide an economic resource to others to improve its own interests. For example, management may decide to provide refunds to its major customers to encourage future sales, although it has a written policy of not issuing

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[16] *Shorter Oxford English Dictionary*, Fifth Edition, 2002: *Estoppel*: Law—The principle which precludes a person from asserting something contrary to what is implied by a previous action or statement or by a previous judicial determination concerning that person.

[17] CON 6, paragraph 40.

refunds. However, the entity in this example not required, either legally or by equivalent means, to provide the refund. Hence, no obligation exists for financial reporting purposes.

63. To be considered an obligation for financial reporting purposes, an entity must be legally required or required by other external equivalent means to fulfill, otherwise satisfy, or settle these types of obligations. That means that apparently similar obligations may qualify as obligations for financial reporting purposes in one legal and operating environment, but not in another, different environment.

64. Liabilities necessarily involve other parties. An obligation to oneself cannot be a liability. For example, in the absence of external requirements, an entity is not obligated to repair the roof of its building or maintain its plant and equipment. While the repair or maintenance might be a wise business move, the entity may defer such activities without incurring legal penalties or equivalent external enforcement. The identity of the other party or recipient need not be known to the obligated entity before the time of settlement.[18]

Present Obligation

65. The second essential characteristic of a liability is that the obligation exists at the financial statement date. Thus, the entity must have a *present* obligation. Consistent with the concept of a *present* right in the asset definition, a present obligation must have arisen from past transactions or other past events. Transactions or other events expected to occur in the future do not in themselves give rise to obligations today (see paragraphs 35 and 36).

66. An intention to purchase inventory does not, of itself, create a liability. However, a contractual obligation that requires an entity to pay more than the inventory is worth may create a liability before the inventory is received, reflecting what the entity might have to pay to undo the unfavorable contract.

67. The corollary is that an entity still has a liability if the transactions or other events that settle or satisfy the obligation are yet in the future. For example, a liability remains, even if the entity has set aside cash for settlement of the liability in the future.

[18] Derived from CON 6, paragraph 36.

Providing or Forgoing Economic Resources

68. The third essential characteristic of a liability is that the obligation 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. The obligation establishes the responsibility of the entity to act in the future to fulfill the requirements of the obligation or otherwise satisfy or settle the obligation. There is a range of actions an obligated entity could take, including to pay, transfer, negotiate and settle, or not pay and experience the consequences.

69. To be a liability, the economic resources to be provided must be economic resources of the entity. An obligation to provide to a third party economic resources of other third parties is an obligation of the entity only to the extent that it would have to expend its own economic resources in doing so.

70. Most liabilities require the obligated entity to pay cash to one or more identified other entities.[19] Obligations also can be fulfilled, satisfied, or settled in a number of other ways, including by transferring assets other than cash, granting a right to use an asset, providing services, replacing that obligation with another obligation, or converting the obligation to equity.[20,21] Such obligations are often documented, including how the entity is required to fulfill the obligation and when—by a specified date or when specified events occur. For example, a receipt of cash results in an obligation if the entity receiving it is expected to provide a good or a service on a certain day or to refund the cash if the good or service is not provided. Such actions represent outflows of the entity's economic resources.

71. Other liabilities may obligate an entity to stand ready to provide a service to another entity. A stand-ready obligation is an unconditional obligation to provide a service if or when required. For example, an entity may provide a one-year warranty to a customer to correct any product defects that occur. An obligated entity fulfills such an obligation by standing ready to provide the repair service. However, even if no claims are made for repair and no repair services are rendered to the customer, the entity will have rendered service in the form of protection from repairs during the warranty period by assuming the risk of those repairs.

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[19] Quoted from CON 6, paragraph 36.

[20] Derived from IASB *Framework*, paragraph 62.

[21] Settlement of an obligation through the issuance of an entity's own shares is to be analyzed and discussed separately in considering liabilities & equity.

72. Some kinds of obligations are not satisfied by transferring or using assets, or by providing or standing ready to provide services. Instead, they are satisfied by *refraining* from engaging in certain types of activities or *standing aside*. Examples include agreements not to compete. For example, an entity might receive a payment not to engage in certain business activities that otherwise could generate future economic resources. In this situation, the entity is obligated not to take a specified action. Such obligations to stand aside require foregoing a possible future economic resource in the form of possible future cash inflows from revenues. Because the entity is not yet entitled to those future revenues, they are not its assets and, therefore, the obligated entity is not required to sacrifice any of its present assets. Rather, the entity is required to forego possible future assets and would be required to pay the counterparty if it breached the contract. For example, a full service airline might enter into an agreement with a low fare airline that has the capacity to expand into only one new market each year, not to expand to the former airline's home market for a year. In exchange for a cash payment from the full service carrier, the low fare airline agrees to stand aside from accessing the other's home market, although it remains free to access other new markets. The low fare airline has a liability—the obligation not to enter the full service airline's home market for one year.

73. An obligation also may be extinguished by different means such as a compromise with the counterparty, or by a creditor waiving or forfeiting its rights.

74. As long as there is a non-zero probability or expectation of there being an outflow or other sacrifice of the entity's economic resources at the financial statement date, then the entity has an obligation to provide economic resources to others.

Other Characteristics That May Assist in Identifying a Liability

75. Liabilities commonly have other features that help identify them. Most liabilities require the obligated entity to pay cash to one or more identified other entities. Most liabilities also would require that immediate settlement with the counterparty or transfer to a third party prior to its performance or extinguishment would necessitate paying cash, transferring or sacrificing other assets, incurring another liability, or issuing shares. Either of those characteristics are strong evidence that a liability exists. However, those features are not essential characteristics of liabilities. Their absence, by themselves, is not sufficient to preclude an item from qualifying as a liability.[22]

[22] Derived from CON 6, paragraph 36.

Examples of Liabilities

76. Accounts and notes payable, wages and salaries payable, long-term debt, interest and dividends payable, and similar requirements to pay cash as a result of a past event clearly represent a present obligation to provide an entity's economic resources to others, and thus are liabilities.

77. Responsibilities such as those to pay pensions, deferred compensation, and taxes and to honor warranties and guarantees may be satisfied by providing goods or services instead of cash. Nonetheless, they too satisfy the definition of a liability.

78. Receipt of payments for goods or services to be provided, such as subscriptions or rent received in advance, also result in liabilities because the entity is required to either provide its goods or services to those who have paid in advance or, depending on the arrangement, a refund of the amounts received.

79. Gains do not give rise to any obligation to provide economic resources to others and cannot qualify as liabilities. For example, there is no obligation to provide anything to others as a result of a "deferred gain" resulting from an increase in value of a financial instrument.

Comparison of Proposed Definitions with Existing Definitions

Asset

80. The IASB *Framework* defines an asset in the following manner:

> An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.[23]

CON 6 defines assets as follows:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.[24]

81. The Boards have previously agreed that it is unnecessary to include any notion of probability in the definition of an asset (December 2005, reconfirmed in February 2006). As noted in paragraph 19, above, "as long as there is a non-zero probability or

[23] IASB *Framework*, paragraph 49(a).
[24] CON 6, paragraph 25, footnote reference omitted.

expectation of economic benefit to the entity at the financial statement date, then an entity has an economic resource"

82. The Boards have previously agreed, also, that it is not necessary to explicitly refer to past transactions and other events in the definition of an asset (December 2005, reconfirmed in February 2006) if we refer to *present* rights, since *present* rights can have arisen only as a result of past transactions or events. Furthermore, *present* rights exclude both past and future events, thus establishing that an asset exists only when it has the rights, and no longer exists when it no longer has those rights.

83. The need for control over the resource (IASB) or the economic benefits (FASB) has been replaced by referring to *rights or other privileged access* to economic resources. [Two sentences omitted from Observer Notes] Of note is that each of the existing definitions refers to control "by the enterprise" (IASB) or "by a particular entity" (FASB), in each case associating the thing controlled with the entity. This is achieved in the proposed working definition by referring to an asset as being an economic resource *of an entity*.

84. The final significant change from the existing definition of an asset is to refer to economic resources and to explain what those are in amplifying text, rather than referring to "a resource from which economic benefits [are expected to] flow" (IASB), or "[probable] future economic benefits" (FASB).

Liability

85. The IASB *Framework* defines a liability in the following manner:

> 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 enterprise of resources embodying economic benefits.[25]

CON 6 defines liabilities as follows:

> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.[26]

86. As with the analysis of the proposed definition of an asset compared with existing definitions, the proposed definition of a liability removes any notion of probability, and does not explicitly refer to past transactions or other events in its definition.

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25 IASB *Framework*, paragraph 49(b).
26 CON 6, paragraph 35, footnote references omitted.

87. The notion of "the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits" (IASB) and "future sacrifices … to transfer assets or provide services to other entities in the future" (FASB) is captured in the proposed definitions by reference to an "economic obligation," described as an "obligation to provide its economic resources to others or forgo economic resources that it might otherwise be able to obtain."

88. The other difference from existing definitions arises from the amplifying text, whereby we propose to limit obligations to those arising from legal or equivalent requirements. As a result, moral obligations and those arising when management of an entity is economically motivated to provide another entity with an economic resource to improve its own interests, would not generally create liabilities in accordance with the proposed definition.

Comparison of Proposed Definitions with those Presented in February 2006

Asset

89. In February 2006, the staff proposed the following definition of an asset:

    An asset of an entity is:

    a. Cash held by the entity

    b. A present right of the entity to cash

    c. 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.

90. The Boards agreed that:

    a. The phrases "cash held by the entity" and "a present right of the entity to cash" are not necessary because those items meet part (c) of the definition, as modified

    b. The phrase "either directly or indirectly" should not be included in the definition but rather explained in amplifying text.

    Therefore, the remainder of the definition of an asset from February 2006, is:

    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.

91. The essential differences between this, and the working definition of an asset proposed in this paper are that:

    a. The idea of a "right or other present privilege" is explained in amplifying text—in terms of advantages beyond the common advantages of others

    b. Rather than referring to "a resource that is capable of generating economic benefits to the entity," the proposed working definition now refers to "an economic resource," but explains in the amplifying text that an economic resource is one that has a non-zero-likelihood of being economically beneficial to the entity.

Liability

92. In February 2006, the staff proposed the following definition of a liability:

> A liability of an entity is its present obligation to one or more other entities that compels potential outflows or other potential sacrifices of economic benefits.

93. The essential differences between this and the working definition of a liability proposed in this paper is that the phrase "to one or more other entities that compels potential outflows or other potential sacrifices of economic benefits" has been replaced by reference to an "economic obligation," explained as being an "obligation to provide its economic resources to others or forgo economic resources that it might otherwise be able to obtain."

APPENDIX A

Summary of Tentative Decisions Reached in February 2006

[From FASB Action Alert—March 9, 2006[27]]

Definition of an Asset

1. The Board discussed the following proposed working definition of an asset that reflects revisions resulting from Board decisions reached in December 2005:

> *An asset of an entity is:*
>
> *a. Cash held by the entity*
>
> *b. A present right of the entity to cash*
>
> c. *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.*

The Board agreed that:

a. The notion of *other present privilege of the entity* is better than *other access* (as proposed in December 2005)

b. The phrases *cash held by the entity* and *a present right of the entity to cash* are not necessary because those items meet part (c) of the definition, as modified

c. The words *either directly or indirectly* should not be included in the definition but rather explained in amplifying text.

2. The proposed working definition should be tested by applying it to certain accounting issues that have been difficult to resolve.

3. The Board provided other suggestions and clarifications for further consideration, including particular wording for the definition and its amplifying text.

Definition of a Liability

4. The Board discussed the following proposed working definition of a liability:

> *A liability of an entity is its present obligation to one or more other entities that compels potential outflows or other potential sacrifices of economic benefits.*

5. The Board agreed that:

   a. *Liability* should continue to be defined directly, with reference to assets.

   b. It is the present obligation, not the future sacrifice, that is the liability.

[27] FASB Action Alert and IASB Update, February 2006, were, essentially, the same.

c. An obligation to forgo a cash inflow or to stand aside can be a liability, or perhaps a reduction in an asset.

d. Only an obligation to one or more other entities can be a liability.

e. The notion in the current definition of little or no discretion to avoid a future sacrifice should be replaced, perhaps by a notion of legal or equivalent compulsion.

f. The definition need not include "probable" or other notions of likelihood, which instead belong in recognition criteria or measurement.

g. Explicit reference to past events is unnecessary—redundant—because a present obligation can only have arisen from past events.

APPENDIX B

Current Status of Cross-cutting Issues

The following lists the cross-cutting issues identified regarding the definitions of an asset and a liability and the current status of their resolution.

Assets

EL1: Should assets be defined in terms of rights or resources? E.g., securitization—selling rights to future revenues, but those rights are not recognized.

We think that "rights or other access" is a more useful notion and recommend that it be introduced (December 2005 paper—paragraph 45, as amended by the February 2006 paper—paragraph 30). That phrase is modified to refer to "rights or other privileged access" in the amplifying text in this paper.

EL2: What does control mean, e.g., insurance renewals—don't control a person paying premium but can restrict others' access to it.

The preliminary view is that renewal rights can create privileges and, hence, the possibility of an asset existing (February 2006 paper—paragraphs 75–79). Further analysis and discussion is expected later in 2006. Also see paragraph 44 of this paper.

EL3: What is controlled—the resource/right that gives rise to future economic benefits or the future economic benefits themselves?

See paragraphs 32–34 of this paper.

EL4: Are the above questions related to a difference between the terms *control* and *compel*? E.g., loans—can compel repayments; other assets—cannot compel but if counterparty chooses to pay then those payments are made to the entity. (Scheduled for discussion later in 2006.)

Outstanding.

EL5: Which future economic benefits are included—where does asset end? (Scheduled for discussion later in 2006 in conjunction with unit of account issues—also see February 2006 paper—paragraph 49.)

Outstanding.

EL6(a): Does control belong in the asset definition or should it be part of the recognition criteria?

We think that it is preferable to include an aspect of associating an asset with the entity in the asset definition. (December 2005 paper—see paragraph 53.)

EL6(b): Is it preferable to have a broad set of assets at the elements level that is refined at the recognition level?

We think it preferable to reserve the right to conclude that certain things that meet the definition of an asset for accounting purposes might, nonetheless, not be recognized for practical reasons. (December 2005 paper—see paragraph 21.)

EL7: What is the event that results in an asset being "obtained or controlled" by an entity?

In the proposed working definition, this question becomes less significant. If the essential criterion is whether an entity has a *present* economic resource then consideration as to what the event is that gave rise to that present economic resource is not essential to the definition of an asset. (December 2005 - see paragraph 59)

EL8: Are accounting assets different from economic assets? If so, why?

We think that accounting assets include all economic resources, but only if economic resources are defined in a manner to restrict them to those that are scarce and useful for carrying out economic activities, such as consumption, production, and exchange. (December 2005 paper—see paragraph 14.)

EL9: What about *stand-ready* assets—opposite of *stand-ready* liabilities?

We think that stand-ready assets are assets under the proposed asset definition (February 2006 paper—see paragraph 72.)

EL10: Why is internally generated goodwill not recognized—does this relate to the asset definition or recognition criteria? (Scheduled for discussion later in 2006 in conjunction with unit of account issues.)

Outstanding.

EL11: Options over assets—not addressed in this paper.

EL12-15 The effects of uncertainty—not addressed in this paper, except for EL12, in part (see below).

EL.12: The role of *probable* or *expected* in the definition of elements, [recognition criteria and measurement][28]. For example, does a flow of economic benefits to or from the entity need to be *probable* or *expected* for an asset or liability to exist or be recognized? If so:

a. What do we mean by *probable* or *expected*?
b. Is this notion part of the elements definitions, recognition criteria, or measurement?

[28] The role of *probable* or *expected* in recognition criteria and measurement will be considered later in the "effects of uncertainty" part of Phase B of the conceptual framework project.

c. If included in the elements definitions or recognition criteria, what are the implications for different measurement attributes (e.g., historical cost and fair value)?

We think that probability should have no role in the elements definitions (see paragraphs 19 and 74 this paper).

Liabilities

EL16: What is the past transaction or event that gives rise to the present obligation?

If there is a present obligation, some past event must have given rise to it. However, it would be superfluous for the definition to include a requirement for there to have been a past event. (February 2006 paper—see paragraph 80.)

EL17: If an entity agrees to forego a cash inflow or has an obligation to stand aside, is that a liability?

That is a liability, and the framework should make that clear (February 2006 paper—see paragraph 25.)

EL18: What are equitable or constructive obligations—Are they promises that a court of law would enforce or something broader than that? E.g., preference share dividends, employee bonuses, projected benefit obligation, and other unvested benefits. Are there constructive obligations that are not legally enforceable? Do these notions work across different jurisdictions (e.g., *equitable* obligations, *promissory estoppel*)?

Liabilities are limited to obligations that an entity would be legally or equivalently required to honor.

EL19: Can economic compulsion give rise to a present obligation and, if so, what does it mean?

No. (February 2006 paper—see paragraph 66.)

EL20: Is the liability the future sacrifice itself or the obligation to make the sacrifice?

The liability is the obligation to make the sacrifice. (February 2006 paper—see paragraphs 68–70.)

EL21: Could the entity have little or no discretion to avoid a future sacrifice and have no present obligation?

No. (February 2006 paper—see paragraph 79.)

EL22: Is there a liability if settling an obligation gives rise to an equivalent asset (e.g., forestry replanting)?

Outstanding

EL23: Is a clean-up obligation a liability or impairment of an asset?

Outstanding

EL24: Does a future commitment (e.g., to pay next year's salaries) give rise to a present obligation?

No. But a *present* commitment to pay in the future may exist and if so does give rise to a present obligation. We would avoid using the curious term *future commitment*. (February 2006 paper—see paragraph 77.)

APPENDIX C

Existing Definitions of the IASB, FASB, National Accounting Standards Setters, and Others

Definer	Asset	Liability
IASB	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. (paragraph 49)	A **liability** is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. (paragraph 49)
FASB	**Assets** are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. (paragraph 25)	**Liabilities** are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. (paragraph 35)
Australia	**"Assets"** are future economic benefits controlled by the entity as a result of past transactions or other past events; and "control of an asset" means the capacity of the entity to benefit from the asset in the pursuit of the entity's objectives and to deny or regulate the access of others to that benefit. (paragraph 14)	**Liabilities** are the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events. (paragraph 48)
Canada	**Assets** are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained. (paragraph 29)	**Liabilities** are obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future. (paragraph 32)
Germany	An **asset** is a resource controlled by an enterprise as a result of past events. The inflow of future economic benefits is expected as a result of the utilisation of that asset within the enterprise or as a result of its disposal. (paragraph 66)	A **liability** is a present obligation to an external party arising from past events. The outflow of resources is expected as a result of the settlement of the obligation. (paragraph 70)
Japan	**Assets** are economic resources or their equivalents that the reporting entity controls as a result of past transactions or events. (paragraph 4)	**Liabilities** are obligations or their equivalents to give up or deliver the economic resources that the reporting entity controls, as a result of past transactions or events. (paragraph 5, footnote reference omitted)

New Zealand	**Assets** are service potential or future economic benefits controlled by the entity as a result of past transactions or other past events. (paragraph 7.7)	**Liabilities** are the future sacrifices of service potential or of future economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events. (paragraph 7.10)
United Kingdom	**Assets** are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events. (paragraph 4.6)	**Liabilities** are obligations of an entity to transfer economic benefits as a result of past transactions or events. (paragraph 4.6)
CFA Institute – Comprehensive Business Reporting Model (pg 19)[29]	An enterprise must recognize an economic resource as an **asset** in the financial statements when all of the following conditions are met: a. The resource is a present right or other access to a future benefit that will flow to the company and will contribute directly or indirectly to future net cash inflows; b. The right to the future benefit is controlled by the company; c. There is a nonzero probability that the benefit will occur; d. The right to the future benefit is separable from the company; that is, it can be transferred to an external party; e. The right to the future benefit is the result of past events; and f. The fair value of the right to future benefits can be measured.	An economic obligation must be recognized as a **liability** in the financial statements when all of the following conditions are met: a. The obligation exists currently; b. There is a nonzero probability that the obligation will be settled by an outflow of assets, issuance of another liability, or other settlement that will result in a change in the share of net assets available to current shareowners; c. There are sufficient penalties to the enterprise from nonperformance that the enterprise has no realistic alternative to settlement; d. It does not meet the definition of equity; and e. The economic attributes and fair value of the obligation can be measured.
U.S. Federal Accounting Standards Advisory Board – Revised Draft Statement of	An **asset** is a resource that embodies economic benefits or services that the federal government can control.	A **liability** is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

[29] *A Comprehensive Business reporting Model: Financial Reporting for Investors*, CFA Centre for Financial Market Integrity, September 2005. Note that these definitions mix both the definition of the element and the criteria for recognizing it.

Federal Financial Accounting Concepts No. 5 (pgs. 7 and 17), December 2005		
Oxford English Dictionary Online	**Asset**: A thing or person of use or value.	**Liability**: The condition of "being bound or obliged by law or equity" and also as "the condition of being exposed to or subject to, or likely to suffer from [something burdensome]." [30]

[30] This definition combines *liability* and *liable*.