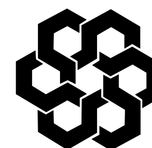

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International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**16 November 2006, London**
Project:	**Conceptual Framework**
Subject:	**Phase B—Elements: Distinguishing Liability from Equity (Agenda Paper 3A)**

INTRODUCTION

1. This paper discusses alternatives to sharpening the distinction between liabilities and equity in defining those terms as part of the "elements" phase of the joint IASB/FASB Conceptual Framework Project. The paper describes reasons to consider alternatives and identifies two possibilities—define only a single element, such as "claims," or to define a third element, "dequity." The paper is primarily informational. It recommends only that the staff be given time to investigate the alternatives so that the Boards can give the matter further consideration at a future meeting

BACKGROUND

2. This is the second paper that discusses issues relating to the definitions of liability and equity and the distinction between them. The first paper was discussed at the April 2006 IASB Meeting (IASB Agenda Paper 8B) and at the April 19, 2006 FASB Educational

Meeting (FASB Memorandum 26). Since more than six months have elapsed since then, a brief review at the outset is warranted.

3. The first paper identified similarities in and differences between the definitions of liabilities and equity and the (limited) discussion of the distinction between them 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 differing aspects in the conceptual frameworks of other standard setters. It also reviewed recent standards issued by the IASB and FASB in this area and the current FASB Liabilities and Equity Project, focusing on what those standards-level efforts revealed about Board preferences.

4. The paper also posed a classification question about four simple financial instruments and recommended one of several possible internally consistent conceptual answers to that question that point toward possible approaches to distinguishing liability instruments from equity instruments. However, Board members were mixed in their views about the possible conceptual answers that the paper posed.

5. That paper pursued the same general approach that the FASB has been pursuing in its Liabilities and Equity Project, namely trying to sharpen the distinction between those financial instruments that should be regarded as liabilities and those that should be regarded as equity. That approach followed from the 1990 FASB Discussion Memorandum (DM), *Distinguishing Between Liability and Equity Instruments and Accounting for Instruments with Characteristics of Both,* which focused mainly on issues associated with trying to sharpen the distinction between liabilities and equity. (The DM also briefly discussed several other approaches that would not attempt to sharpen that distinction, but did not explore them or what their implications might be in depth).

6. [Paragraph omitted from Observer Notes].

7. Ten years after issuing the DM and following extensive deliberations, the FASB issued two Exposure Drafts, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both* and *Proposed Amendment to FASB Concepts Statement No. 6*

to Revise the Definition of Liabilities. However, after analyzing the comments received on those Exposure Drafts and redeliberating the issues, the FASB decided to conduct the project in two phases. The first phase was ostensibly completed with the issuance of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.

8. However, the effective date of some of the requirements in Statement 150 has been deferred indefinitely because of unforeseen consequences, and the issues are being reconsidered in Phase 2. Based on its Phase 2 deliberations, the FASB now plans to issue a due process document in the second quarter of 2007. That document is currently expected to discuss three alternative ways of distinguishing between liabilities and equity, and it is possible that no single view will attract the support of a majority of the Board members. That plan makes it apparent that the FASB is not as close to an answer as it thought it was when it issued the Exposure Drafts six years ago. That illustrates the obstacles the FASB has encountered in attempting to draw a hard-and-fast bright line between liabilities and equity.

9. The challenge is to draw that line without resorting to what might be seen as little more than "a bag of rules" that lacks a sound conceptual basis. The three alternatives currently under consideration in the liabilities and equity project are likely to be viewed as rules-based instead of principles-based and also as overly complex.

10. That brings us to the Conceptual Framework Project. Phase B of this project includes converging and improving the existing definitions of elements. As the Boards wrap up their deliberations of the definition of an asset, we will be at a point where the next logical step will be to consider how to go about improving and converging the existing definitions of liabilities and equity.

11. The Boards have indicated a preference for a liability definition that parallels the asset definition, as is the case with the existing definitions in the FASB and IASB frameworks. The staff will propose a revised working definition of an asset for the Boards' consideration at this meeting (see Agenda Paper 3). Although the staff is not at this time also proposing a revised working definition of a liability for the Boards' consideration,

Agenda Paper 3 suggests one possible definition that the staff thinks would parallel the revised working definition of an asset. However, while such a definition would parallel the definition of an asset, it would do little, if anything, to help better distinguish between liabilities and equity.

12. That raises a tactical question: Should the Conceptual Framework Project team:

    a. Take the same approach as that being taken in the Liabilities and Equity project, namely, to try to sharpen the distinction between liabilities and equity (as was attempted in our first paper on this topic as discussed above), or

    b. Explore one or more other approaches?

13. [Paragraph omitted from Observer Notes].

14. With regard to (b), however, the Conceptual Framework Project team might be able to add value by pursuing one or more other approaches. This memorandum explains why the Conceptual Framework Project team plans to explore other approaches, what those approaches might be, and what might be gained from exploring them.

WHY EXPLORE ALTERNATIVE APPROACHES?

15. The reasons for pursuing other approaches in this project stem from two main questions:

    a. **Can** a hard-and-fast bright line be drawn between liabilities and equity that results in faithful representations?

    b. **Must** such a bright line be drawn?

Can a Line Be Drawn That Results in Faithful Representations?

16. There are several reasons for questioning whether a hard-and-fast bright line *can* be drawn between liabilities and equity that results in faithful representations of the items on either side of that line. One reason relates to the legal distinction between liabilities and equity versus the economic substance of the instruments being classified as one or the other. Another reason relates to unintended consequences that have resulted from standard setters having drawn such lines in the past. Still another reason involves the overlapping nature of the instruments being classified as either debt or equity.

Legal Form vs. Economic Substance

17. The staff acknowledges that, under the law, obligations (liabilities) differ from ownership interests (equity). However, should that necessarily be determinative? While liabilities and equity are different in current standards, the distinction is not the same as the legal distinction. For example, equity derivatives are created under contract law rather than ownership law.

18. There are many instances where financial reporting diverges from what would be solely a legal interpretation of the situation. Indeed, accountants often are admonished to focus on "substance over form" and not to let the legal form of an item take precedence over its economic substance.

19. Faithful representation is one of the primary qualitative characteristics of financial reporting information that is useful to investors and creditors. Such information is predominantly economic in nature. Although legal aspects must be considered because they can have significant economic consequences that cannot be ignored, those legal aspects that have little or no economic effect should not be allowed to dominate financial accounting and reporting.

20. Indeed, as the Basis for Conclusions for the Qualitative Characteristics chapter in the Preliminary Views document states:

> 13. The Boards concluded that the qualitative characteristic of *faithful representation* encompasses ensuring that financial reports represent the substance of an economic phenomenon (such as a particular transaction) rather than solely its legal form. To represent legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation. Therefore, the quality of faithful representation is incompatible with representations that subordinate substance over form. Accordingly, this framework does not identify *substance over form* as a component of faithful representation because to do so would be redundant. [Paragraph BC2.18]

Unintended Consequences of Bright Lines

21. Standard setters' past experience with setting hard-and-fast bright lines in financial reporting standards has been less than wholly satisfactory. Although the reason for establishing those lines has been to provide clear and unambiguous guidance to preparers and auditors, those lines also have had unintended consequences. In many instances, the objective of the standard has been undermined by reporting entities using bright lines as a benchmark for transaction structuring so as to achieve the financial reporting results that they desire.

22. [Paragraph omitted from Observer Notes].

23. Also, trying to establish a hard-and-fast bright line to distinguish liabilities from equity is almost certain to enable reporting entities to structure their financing securities in ways that will allow those securities to be categorized either as liabilities or equity, depending on how the reporting entity wishes them to be categorized. Part of the problem is that drawing the line in such a way that is thought to be ideal from one perspective may be undesirable from other perspectives. As a result, the line will facilitate financial engineering opportunities from those other perspectives.

Overlaps Among Corporate Securities

24. Corporations finance themselves by issuing a wide range of securities, including bonds, preferred shares, and common shares. Moreover, the types of securities in each of those classes also may span a wide range. Those ranges may overlap so much that other than tax treatment of interest and dividends, there may be no significant difference between instruments labelled "debt" and instruments labelled "equity".

25. Corporate debt securities (bonds) range from asset-backed securities to income bonds. They may be callable or noncallable, cumulative or noncumulative, and may include features such as convertibility into shares. Corporate bonds include asset-backed securities, mortgage bonds, collateral trust bonds, debenture bonds, and income bonds. Asset-backed securities are as nearly risk free as possible and, if properly collateralized

and structured, can merit a higher credit rating than the rating of the issuer even on its other secured debt. Even though mortgage bonds involve specific liens, they may involve a first, second, third, or other mortgage, and consequently vary considerably in the degree of principal protection they provide. Debenture bonds do not involve specific liens and rest instead on the general credit of the corporation, thereby affording less protection of principal. Debenture bonds may have different levels of subordination (sometimes labelled senior debentures and junior debentures). Income bonds, which pay interest only if sufficient income is available, are even more speculative than debentures.

26. Convertible bonds may be priced almost as if they were shares if the conversion feature is "in the money" and the bond pays little or no interest. Prepaid call options are nearly indistinguishable from convertible bonds, and penny warrants are nearly indistinguishable from nonvoting shares.

27. Although bondholders generally lack voting rights in the corporation, they may supplant both common and preferred shareholders in the case of insolvency, bankruptcy, or reorganization.

28. Finally, some debt instruments are described as perpetual, that is, they may have no maturity date and pay only interest. Such an instrument may be callable and the interest rate may increase over time as a way to induce the issuer to call them. Such perpetual debt instruments are not much different from perpetual preferred shares except in their tax treatment.

29. Shares range from nonparticipating, cumulative, mandatorily redeemable preferred shares to the most speculative class of voting common shares. Preferred shares, while superior to common shares in terms of their claims to returns and their priority in liquidation, also span a wide range. For example, preferred shares may be callable, redeemable, convertible, participating, or cumulative. Nonparticipating, cumulative preferred shares that are mandatorily redeemable on a fixed date are so much like debt instruments that it is hard to see a difference. In contrast, fully participating, noncumulative preferred shares that have a very small preference in liquidation and are not redeemable are very much like nonvoting common shares. While the voting rights associated with preferred

shares generally are more limited than those for common shares (perhaps being limited to having veto power over specified matters of operating or financial policies), preferred shareholders have latent voting rights that may afford them control of the corporation in instances such as financial distress.

30. Common shares, too, can span a wide range, including being callable or redeemable. A significant distinction often involves voting rights, with some classes of common shares having considerably more voting clout than others. For example, although the Ford family holds only about five percent of the outstanding common shares of the Ford Motor Company, family members have approximately 40 percent of the voting power.

31. Thus, not only is there a wide range of corporate securities, but also there is a wide range within each class of securities. As a result, if those securities were to be arrayed according to the degree of principal risk associated with them, they might begin with fully secured bonds such as asset-backed securities, go down through debentures and income bonds, followed by the highly safeguarded redeemable preferred shares, then the less conservative preferred shares, followed by the higher grade common shares, and ending with the most speculative common shares. However, that array might be altered somewhat if it were to be based on the degree of income risk associated with them. The array might be somewhat altered again if it were to be based on the degree of control associated with them, which would in turn depend on the specific financial condition of the corporation at the time. As a result, there can be no single, clear-cut line that distinguishes between the classes of securities.

***Must* a Line Be Drawn Between Liabilities and Equity?**

32. There are several reasons for questioning whether a hard-and-fast bright line must be drawn between liabilities and equity. One reason relates to the history of the line, specifically why the line between liabilities was originally drawn. Another reason relates to the cross-cutting issues.

Historical Origins of the Line Between Liabilities and Equity

33. One of the most fundamental (and ancient) issues in accounting concerns which perspective should be the basis of the financial reporting. That is, should the financial status of a reporting entity (and subsequent changes in that status) be viewed from the perspective of the owner(s) of the entity (the proprietary perspective) or the entity itself (the entity perspective)?

34. Early American writers on the subject favored the proprietary perspective. For example, Charles E. Sprague regarded the most natural expression of the accounting equation to be assets minus liabilities equals proprietorship, or A – L = P.[1] Henry Rand Hatfield elevated proprietorship even more by reducing the equation to "goods equals proprietorship," wherein the "goods" class is divided into positive and negative components, with liabilities being treated as "negative goods."

35. Under the proprietary perspective, the accounting process is aimed at the determination of proprietorship. That perspective fit logically in an era where the dominant forms of business entities were sole proprietorships and partnerships.

36. In a sole proprietorship, the proprietor is both the manager and owner/investor and has unlimited liability. Although the sole proprietorship is treated as a separate entity for accounting purposes, it does not have a legal existence separate and apart from the proprietor. Accordingly, the assets and liabilities that are deemed to be those of the entity are not in fact legally those of the entity, but rather the assets are legally owned and the liabilities are legally owed by the proprietor. Thus, the sole proprietorship's assets are in fact the proprietor's assets. Similarly, the claims of the creditors of the sole proprietorship (generally trade creditors, employee-creditors, and short-term lenders) are in fact claims against the proprietor, and they extend to all of the proprietor's assets, including any other business or personal assets. Since the assets and liabilities attributed to the sole proprietorship are in fact owned or owed by the proprietor, the formulation of

[1] The A – L = P formulation of the accounting equation can be found in many older accounting textbooks.

the accounting equation as $A - L = P$, with the focus placed on determining P, follows logically.

37. The same is true of traditional general partnerships. The partners are both the managers and owners/investors and have unlimited liability. The assets and liabilities that are deemed to be those of the partnership entity are not legally owned or owed by the partnership entity, but rather are owned and owed by the partners jointly. Thus, the partnership's assets are in fact the partners' assets. Similarly, the claims of the creditors of the partnership (generally trade creditors, employee-creditors, and short-term lenders) are not limited to the partnership's assets, but extend to the other assets of the partners themselves, including their other business or personal assets. Those claims may be seen as the joint and several obligations of the partners. Thus, the formulation of the accounting equation as $A - L = P$, with the focus placed on determining P, also follows logically for partnerships.

38. Although that formulation is appropriate for sole proprietorships and partnerships, a good case can be made that it is *not* appropriate for corporations, especially publicly-held corporations. Unlike sole proprietorships and partnerships, the corporation is endowed by the state with attributes that give it a separate existence independent of its members (the shareholders). Moreover, the management of a corporation typically is separate and distinct from its owners, the shareholders, whose liability is generally limited to their investment. In contrast to sole proprietorships and partnerships, the corporation can and legally does own assets. Similarly, the corporation can and legally does owe liabilities. The claims of the creditors of the corporation are not against the corporation's shareholders or its managers, but rather against the corporation itself. Moreover, while some of the creditors are similar to those of sole proprietorships and partnerships (that is, trade creditors, employee-creditors, and short-term lenders), many are long-term capital providers who invest in the corporation's debt securities (such as bonds) and may themselves be seen as investors[2] having investment horizons akin to those of the

[2] As a class, even short-term creditors may be seen as constituting a long-term source of capital for the corporation (albeit one that may not explicitly charge interest) because one short-term debt is routinely replaced by another, often to a previous creditor.

corporation's shareholders. Those "creditor-investors" differ from shareholders principally in their relative appetite for risk. Collectively, those characteristics led William A. Paton[3] to call the corporation the business enterprise **par excellence**, and to describe it as "a genuine business entity."

39. For reasons such as those, the formulation of the accounting equation A – L = P does not necessarily follow logically for the corporation as it does with sole proprietorships and partnerships. Indeed, a corporation's creditors and shareholders have more in common than is usually supposed. Generally speaking, their commonalities are as follows:

    a. They all supply capital to the corporation

    b. All their claims are against the corporation itself and they lack recourse to any other party

    c. Their claims are to interests in the corporation, not to the specific assets of the corporation

    d. They all share in the returns that the corporation generates on its assets

    e. They are not directly involved in the management of the corporation's business activities.

    Collectively, therefore, they might better be described as corporate claimants or claimholders rather than as creditors and shareholders.

40. The principal differences between them relate to:

    a. The relative priority and magnitude of their claims to both:

        (1) the returns generated by the corporation's assets, and

        (2) the proceeds in the event of liquidation of the corporation's assets.

[3] William A. Paton was an accounting professor at The University of Michigan, a prolific author of scholarly work in accounting, the first editor of *The Accounting Review,* the American Accounting Association's premier scholarly journal, and in 1987 was named "Accounting Educator of the Century" by the American Institute of CPAs.

b. Their relative right or ability to exercise control over the corporation and its management, which can vary considerably depending on whether the corporation is in financial distress.

However, those are not fundamental differences, but rather differences only of relative degree.

41. [Paragraph omitted from Observer Notes].

The Cross-Cutting Issues Call for Exploring Other Approaches

42. [Paragraph omitted from Observer Notes].

43. The cross-cutting issues associated with liabilities and equity (reworded somewhat for clarity) are as follows:

EL.25: Should there be a distinction between liabilities and equity?

EL.26 Should there by only two elements? Why not three–debt, equity and "dequity"?

EL.27 How should liabilities and equity be distinguished from each other (for example, shares puttable at fair value)?

EL.28: Should all elements be defined (and if so, will anything fall through the cracks between the definitions), or should one be a residual (and, if so, which one)?

EL.29 Should equity (once determined) be divided into various sub-classes (for example, reporting of parent and non-controlling interests from the investor's perspective as well as the issuer's)? If so, is that division for presentation purposes only, or does it have broader implications?

EL.30 Should minority interests be part of equity?

EL.31 If settlement is to be in the entity's own shares (or other equity instrument), can the entity have gains or losses from transacting in its own equity instruments?

Two of those issues explicitly specify that other approaches should be explored, namely:

EL.25: Should there be a distinction between liabilities and equity?

EL.26 Should there by only two elements? Why not three – debt, equity and "dequity"?

The staff observes that EL.26 could be re-phrased to refer to "three or more" elements, rather than only three.

44. Those two issues are not new issues. In 1990, as part of its Liability and Equity Project, the FASB issued a Discussion Memorandum (DM), *Distinguishing Between Liability and Equity Instruments and Accounting for Instruments with Characteristics of Both,* that included similar issues, as follows:

    14. ISSUE 2.8: Should a third "capital" element be added to handle instruments that combine certain features of liabilities and equity? If so, how should that element be defined?

    15. ISSUE 2.9: Should the present sharp distinction between liabilities and equity be effectively eliminated?

45. With regard to Issue 2.8, the DM described the two major candidates for being added as a new element as "temporary equity" and "contingent equity financing."

46. *Temporary equity* would be created to distinguish financial instruments in *permanent equity* from other financial instruments that are designated as *stock* and, thus, are subject to the legal restrictions on distributions to owners, but whose contractual terms call for redemption or repurchase. Therefore, that category would represent obligations that are required to be repaid in the ordinary course of business, but which provide at least a temporary respite from cash demands if the reporting entity experiences serious financial difficulties.

47. *Contingent equity financing* would be created to include financial instruments that convey rights entitling the holders to become stockholders at their election during specified periods. For example, written call options, purchased put options, warrants, forward contracts to issue shares, and convertible debt instruments would appear in the contingent equity category. Obligations that require the future issuance of stock upon the occurrence of a specified event rather than at the election of the stockholder or issuer also would be included. Such instruments effectively would be liabilities that will not necessarily be settled by sacrificing economic resources of the reporting entity.

48. The DM acknowledged that it would be possible to add both *temporary equity* and *contingent equity financing* as additional elements. The rationale for adding them would be that obligations to issue stock and obligations to repurchase stock are sufficiently

different from each other and from liabilities and equity to justify adding two separate elements.

49. With regard to Issue 2.9, the DM stated that one reason for eliminating or downplaying the distinction between liabilities and equity is because the line between liabilities and equity has outlived its usefulness and attempts to sharpen it are likely to fail. Another reason is that attempting to resolve the issue by adding more elements would likely compound the problem, given the proliferation of new financial instruments that combine features of both debt and equity, and thereby blur the line between liabilities and equity. For those reasons, a different approach is needed, one that would combine liabilities and equity into a single element.

STAFF COMMENTARY

50. Based on the above analysis, the staff thinks that there are good reasons to question both (a) whether a hard-and-fast bright line **can** be drawn between liabilities and equity that results in faithful representations, and (b) whether such a line **must** be drawn.

51. [Paragraph omitted from Observer Notes].

52. [Paragraph omitted from Observer Notes].

53. [Paragraph omitted from Observer Notes].

54. Accordingly, the staff plans to explore cross-cutting issue EL.25. That is, we will consider whether a single element should be defined to comprise what liabilities and equity now comprise. Such an element might be termed "claims" and would be the counterpart to assets. As a result, the statement of financial position would have only two, rather than three, dimensions and would be a statement of assets and claims.

55. A variant on that approach would be to borrow from what the Boards are considering in the Financial Statement Presentation Project. That variant would continue to have a definition of a liability, but restrict it to the negative (operating) items that the Boards are considering displaying on the left-hand side of the statement of financial position, and to

include in "claims" the other items that now meet the definition of liabilities, together with items that are now equity.

56. We also plan to explore cross-cutting issue EL.26. That is, we will consider whether three or perhaps more elements should be defined in place of what the existing frameworks define as liabilities and equity. One possibility might be to restrict the terms *liability* and *equity* to those items that are either 'pure' liabilities or 'pure' equity, and to define one or more "dequity" elements, such as those discussed in the DM.

57. We further plan to consider whether it might be feasible to combine the two approaches. One possibility might be to define a single element of "claims" and to establish financial statement display classifications for 'pure' liabilities, 'pure' equity, and one or more classes of "dequity." Alternatively, if liabilities were restricted to those negative items that the Boards are considering displaying on the left-hand side of the statement of financial position, a display classification for "debt" might be established for the other items that now meet the liabilities definition and would be included in "claims."

58. All of those alternative approaches would have the advantage of avoiding placing such heavy pressure on a single bright line and would instead diffuse that pressure.

Some Financial Reporting Implications of the Alternative Approaches

59. Each of those alternative approaches carries with them certain financial reporting implications that will have to be identified and considered. Our thinking thus far about what those implications might be is only quite preliminary. However, the following are examples of what some of their implications might be.

60. Because the present line between liabilities and equity plays a role in determining what will be reported as income, an approach that replaces those two elements with a single element such as claims could lead to re-thinking of what should constitute the *determinants* of income and the *distributions* of it.

61. Presently, income is determined by means of (certain) inflows and outflows and changes in values of assets and liabilities, with the residual going to equity. Thus, interest

expense (which relates to liabilities) is a determinant of income, as is depreciation expense (which relates to assets), while cash dividends (which relate to equity) are distributions of income. However, a focus on claims rather than liabilities and equity could lead to treating some or all interest as distributions of income rather than as determinants of it.

62. Alternatively, cash dividends might be treated as determinants of income rather than as distributions of it. That may not be as far-fetched as it may initially seem. From time to time, government policymakers in the United States have expressed concerns that the deductibility of interest—but not dividends—for income tax purposes has had the unintended consequence of leading companies to become excessively leveraged, and thereby less stable in the event of economic downturns. That has led policymakers to consider developing a more neutral tax policy by either eliminating the deductibility of interest or allowing the deductibility of dividends for income tax purposes.

63. [Paragraph omitted from Observer Notes].

64. The discussion of different legal forms (paragraphs 33–41) implies that businesses in different legal forms might be required to report differently, for example, sole proprietorships and general partnerships might use a more traditional liability-equity distinction, and corporations might use a new definition of claims. Traditional corporations, partnerships, and proprietorships are not the only legal forms for conducting businesses, and the alternatives vary by legal jurisdiction. Therefore, if entities in different forms were to report differently, it may be necessary to develop concepts or principles to determine which form should be applied by which type of entities. That would not be a necessary outcome, however, because the claims approach could be applied to businesses in other than corporate form.

65. [Paragraph omitted from Observer Notes].

66. [Paragraph omitted from Observer Notes].

67. [Paragraph omitted from Observer Notes].

68. [Paragraph omitted from Observer Notes].

69. [Paragraph omitted from Observer Notes].

70. [Paragraph omitted from Observer Notes].

Staff Recommendation

71. As noted above, the staff has not yet fully thought through each of the approaches and what their implications might be. However, even though these approaches need to be thought through more fully, the staff thinks that they are sufficiently promising to justify exploring more fully. Investing some time now might ultimately lead to a significant payoff.

72. [Paragraph omitted from Observer Notes].

73. If the Boards do not wish the staff to undertake such an exploration, that suggests that issues EL.25 and EL.26 should be expunged from the list of cross-cutting issues that the Boards previously agreed should be addressed. Would the Boards agree to that?

74. Also, if the Boards do not wish the staff to undertake the exploration, that raises the tactical question of what the staff should do next in Phase B of the Conceptual Framework Project (paragraphs 12-14). As previously noted, it is not clear what unique value the Conceptual Framework Project team could add by pursuing the same approach as the Liabilities and Equity Project team, and it would not be a good use of scarce staff resources. However, without definitions of liability and equity or whatever elements might replace them, it would be difficult to consider the other elements definitions that presently are based on the asset and liability definitions. Accordingly, what should be the staff's next steps in Phase B if not to explore the alternatives discussed in this paper?