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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

IASB Meeting:	**17 July 2007, London (Agenda Paper 2A.2)**
Project:	**Conceptual Framework**
Subject:	**Phase B: Elements and Recognition-Status and Priorities**

Introduction & Purpose

1. Part I of this paper provides a summary of the status of Phase B of the Conceptual Framework project, Elements & Recognition. Appendix A summarises the cross-cutting issues to be considered in this Phase and the current status of their consideration. This summary is provided as a refresher of the issues we are considering in this Phase of the project. It provides background information to help Board members evaluate the staff's plans for next steps, in Part II of this paper.

2. Part II of this paper asks the Boards to confirm the staff's plan to temporarily set aside direct work on the asset and liability definitions, and to focus on related topics in Phase B, such as unit of account, recognition and derecognition.

Part I: Summary of Deliberations to Date

Overview

3. Phase B of the Conceptual Framework project includes a wide range of topics that were considered sufficiently inter-related that they must be considered in a single phase. These comprise the following topics:

    a) Asset definition
    b) Liability definition
    c) Liabilities & equity
    d) Other elements
    e) Unit of account
    f) Recognition
    g) Derecognition

4. The status of deliberations on each of these topics is discussed in the next few paragraphs of this paper.

Asset and Liability Definitions

5. The objective of the Conceptual Framework project is to converge and improve upon the existing frameworks of the IASB and FASB. The Boards' existing asset and liability definitions differ in focus and style. They are as follows:

> An **asset** is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. [IASB *Framework*, paragraph 49(a)]
>
> **Assets** are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [CON 6, paragraph 25; footnote reference omitted.]
>
> 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. [IASB *Framework*, paragraph 49(b)]
>
> **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. [CON 6, paragraph 35; footnote references omitted.]

Therefore, at a minimum, to meet the project's objective, at least one set of definitions must change for the Boards to have a converged definition of an asset and a liability.

6. To more fully achieve the project objective, improvements to the working definitions are being proposed to address the following shortcomings in the existing definitions:

   a. Misinterpretation of *likelihood* ("expected" in the IASB and "probable" in the FASB).

   b. Misinterpretation of *control* in the asset definitions.

   c. Placement of undue emphasis on past transactions and events.

   d. Inappropriate focus on future inflows or outflows of economic benefits, rather than the thing that presently constitutes an economic resource or economic burden.

   e. Lack of clarity as to how the definitions apply to contractual promises.

   f. Lack of explicit link of liability definitions to the objective of financial reporting.

7. *Likelihood:* Some misinterpret both the IASB and FASB asset and liability definitions as implying that there must be a high likelihood of future inflows or outflows of economic benefits for the definitions to be met. That is not the intent of the existing definitions. The terms were included to reflect that the item in question need not be certain to meet the definitions. To avoid these continued misinterpretations, the working definitions do not depend on assessing a degree of likelihood to ascertain whether the definition has been met.

8. *Control*: Some view control of a resource (IASB) or of the probability of future economic benefits (FASB) in the asset definitions in the same sense as that used for purposes of consolidation accounting. In today's complex business world, it is not necessary that an entity controls the economic resource—merely that it has rights or other privileged access to it. The working definition uses *rights or other privileged access* to reflect more precisely the manner in which an entity is associated with economic resources.

9. *Past transactions and events:* The references to "past transactions and events" were included in the definitions primarily to exclude future liabilities from meeting the definitions. However, in applying both the IASB and FASB definitions, some place undue emphasis on identifying the past transactions or events that give rise to an asset or a liability. Though that identification might be helpful, it can be a distraction. Instead, the working definitions focus on whether the item (economic resource or economic burden) and mechanism that links the item to the entity (a right or other privileged access, or an obligation) *exist* at the financial statement date.

10. *Future inflows or outflows of economic benefits:* The existing FASB definitions focus on identifying a future inflow or outflow of economic benefits to demonstrate that an asset or a liability exists. As balance sheets report on items that exist (sometimes referred to as *stocks*) rather than on changes in those items (sometimes referred to as *flows*), the working definitions focus instead upon stocks.

11. *Contractual promises:* The existing IASB and FASB frameworks are not as clear as they could be regarding the application of the definitions to contractual promises. The proposed amplifying texts of the asset and liability definitions explain that non-conditional promises qualify as present economic resources or burdens when their performance is presently required (although performance is, perhaps, not yet due).

12. *Cash outflows:* Neither the IASB nor FASB frameworks explicitly tie the liability definitions to the objective of financial reporting to provide information useful to users in making resource allocation decisions, such as information to assess the timing and uncertainty of future cash flows. This link is made more explicit in the proposed definition of economic burden.

Asset Definition

13. In November 2006, the Boards agreed to consult with selected technical experts, as well as the Boards' Advisory Committees and others, on the working definition of an asset. This consultation was undertaken in the first quarter of 2007 and the results are summarised in IASB Agenda Paper 2A.1/FASB Memorandum 59A. Extracts from the paper used for the

consultations, which comprises our latest summarisation of the need to change the existing definitions and the proposed working definition and amplifying text, are provided in the Appendix to that paper.

14. Based on the feedback from the consultations, further clarification and explanation of some of the proposals in the working definitions seems necessary. While the consultations revealed that there are differences of views as to how the definition might better be expressed, there was general agreement that the proposed working definition of an asset captures the right ideas and includes improvements compared to the existing IASB and FASB definitions.

15. Previous Board papers have considered all cross-cutting issues relating to the asset definition,[1] except EL5: Which future economic benefits are included—where does the asset end? This issue includes consideration of the boundary between an asset and a business opportunity, and the effect of renewal and cancellation options in determining what the asset is.

16. Consideration of the first item in issue EL5 is under way. However, it started with the boundary between a liability and a business risk, because the same issue was being considered in the IASB's IAS 37 Liabilities project. The staff and the IASB have been considering this issue since early 2007, in collaboration with staff supporting the IASB's IAS 37 project. The thinking being developed will shortly be discussed by the FASB. As the definition of a liability is a near mirror image of an asset, what we learn about the boundary of a liability will inform the work of determining the boundary between an asset and a business opportunity.

17. Consideration of the effect of renewal and cancellation options in determining what is the asset began in September 2006. At that time the Boards discussed cross-cutting issue EL 11, options over assets, and tentatively decided that, in this case, the asset is the entity's present right to the contractual promise to do something if the option is exercised; the asset is not the underlying item. Following that logic, renewal and cancellation options could be considered separate assets from the primary contract asset. Yet, a contract with a short service period

[1] See Appendix A to this paper for the list of cross-cutting issues.

that has options to renew could provide similar economic benefits as a contract with a long service period that has cancellation options. Ascertaining what the asset is interacts with unit of account issues—i.e., in identifying a particular asset, what related things do we also include in that asset (similar and/or dissimilar items, both good things and bad things)? Therefore, staff think that we cannot fully resolve this issue until we begin considering unit of account issues.

Liability Definition

18. Staff discussed issues associated with the definition of a liability with the Boards in April 2006. Since then, staff have developed a working definition of a liability and amplifying text, but have not discussed that with the Boards, except in providing the working definition of a liability as a near mirror image of the working definition of an asset. [The working draft of the liability definition is provided in Appendix B to this Observer Note; the staff's paper of the working draft of the amplifying text supporting the definition of a liability is omitted from Observer Notes.]

19. We cannot complete work on the definition of a liability until we are in a position to deal with the boundary between liabilities and equity (now deferred—see paragraph 23, below). However, we can address aspects of the work on the definition of a liability that rule out things that would be neither liabilities nor equity.

20. Also, we cannot complete work on the definition of a liability until we have dealt with the boundary between liabilities and business risks. As noted above, staff have been collaborating with the IASB's IAS 37 Liabilities project team on distinguishing the boundaries between a liability and a business risk. The IASB has discussed this work in March and May 2007 and we plan to discuss these issues with the FASB shortly, before finalising these discussions in the third quarter of 2007.

21. The following cross-cutting issues relating to the definition of a liability have not yet been discussed with the Boards:

EL18: What is "equivalent to legal"? This is an issue that has been identified also in the consultation on the definition of an asset and was also considered by the IASB in

May 2007 in conjunction with its redeliberations of IAS 37 and discussion of constructive obligations.

EL22: Is there a liability when settling an obligation gives rise to an asset? Staff think that this is, in part, a unit of account question and cannot be resolved until we begin work on that topic.

EL 23: Is a clean-up obligation a liability or an asset impairment? Staff think that this is, in part, a unit of account question and cannot be resolved until we begin work on that topic.

22. To test the liability definition, staff need to develop a range of examples to ascertain under which circumstances the liability definition is met.[2]

Liabilities and Equity

23. In November 2006, the Boards considered the first two cross-cutting issues of the liabilities and equity phase and directed the staff to expedite exploring an approach that would replace the liability and equity elements with a single element (claims). The implications of that approach were discussed in February 2007. In April, the Boards decided to defer further work on this part of Phase B of the Conceptual Framework project pending the forthcoming FASB Preliminary Views document, and expected IASB Discussion Paper, on the related standards-level project and constituents' comments on that document. Therefore, we will not be in a position to return to this issue, or finalise the definition of a liability, before mid-2008.

Other elements

24. This aspect of Phase B deals with convergence of the flow elements (the IASB's definitions of income and expense versus the FASB's definitions of comprehensive income, revenues, expenses, gains, losses, investments by owners and distributions to owners) and potential other elements (such as cash flow elements). Staff noted, in April 2007, that further work on this topic can, to some extent, leverage off active standard-setting projects (for example, revenue recognition and financial statement presentation). Also, we are limited in the

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[2] We think it might be helpful to develop a case book of asset and liability examples to illustrate the application of the element definitions as intended by the Boards (perhaps based, in part, on those used for the 2006 AAA/FASB conference). But, resource constraints have precluded our doing so.

progress we can make on this aspect until we are ready to reactivate work on liabilities and equity. Therefore, work in this area is not part of our immediate plan.

25. This topic also includes considering net income versus comprehensive income, including the possible role of net income and other comprehensive income. Work has not yet commenced on this subject—and is likely to be informed by present deliberations in the joint project on Financial Statement Presentation.

Unit of Account, Recognition and Derecognition

26. We have not yet commenced work on any of these aspects of Phase B. Part II of this paper explains why we think it is time to begin doing so

27. The Boards' current frameworks provide no guidance on how the unit of account (the “thing” that is to be accounted for) should be determined. We intend to develop conceptual guidance to assist in analysing such issues that arise in various standards projects. They include, for example:
    a. Should similar things be accounted for together, rather than separately?
    b. Should some "related" assets and liabilities be accounted for together or netted?
    c. Should an entity define/recognise assets and/or liabilities arising in contracts that are still fully executory? If so, what are the assets and liabilities and should the entity account for and report them separately or account for them as a single net item?
    d. How do we identify, or specify, the thing that is to be accounted for (for example, in the case of a lottery ticket, identifying the asset as the participation in the lottery, rather than the prize resulting from the lottery draw)?

    Several of the cross-cutting issues relating to the definition of an asset and a liability cannot be completely resolved until we have considered some of the unit of account issues.

28. The Boards' current frameworks contain recognition criteria, some of which are similar and others that are different. Neither Board's frameworks contain criteria as to when an item should be derecognised. We plan to address those differences and provide a framework for resolving derecognition issues. We are already facing issues relating to the boundary between

the definition of an asset and liability and recognition in considering business opportunities versus assets and business risks versus liabilities.

Part II: Next Steps

Analysis

29. We have made significant progress on asset and liability definitions, but still have some more work to do—more so on liabilities than on assets. However, we have not yet started to consider any of the issues relating to unit of account, recognition or derecognition.

30. At one time, staff had contemplated the possibility that the asset and liability definition topics in this phase might be capable of separation from the rest of the topics, for separate due process consultation. However, staff think that it has become clear that the interactions between the topics in this phase make it infeasible to separate those topics (see, for example, comments from those consulted on the definition of an asset in IASB Agenda Paper 2A.1/FASB Memorandum 59A, as well as discussions in the remainder of this paper).

31. At the April joint IASB/FASB meeting, various views were expressed about next steps in Phase B of the project:

    a. Some Board members observed that there remains further work to do on the asset and liability definitions. Staff agree.

    b. Other Board members suggested that we should have one more go at wrapping up the definition of an asset before moving on to other issues. Staff note that even if we were to attempt that, we could not *finalise* the definition at this time (see below for further discussion).

    c. Still other Board members questioned whether we could conclude on definitions of an asset or liability before considering some other issues in Phase B because consideration of those issues might help us with revising the definitions. Staff agree.

    d. Yet other Board members suggested that we might get a better pay-off for standards-level projects if the Conceptual Framework project addresses some of the cross-cutting issues relating to unit of account, recognition and derecognition, rather than trying to finalise the definitions of an asset and a liability at this time. Staff agree.

Views similar to those in sub-paragraphs c and d were also expressed by FASB Board members at a FASB Technical Plan meeting in March 2007.

32. We note that, in assessing the best way forward, we have taken into account resource constraints. In an ideal world, we might work concurrently on both definitional and unit of account, recognition and derecognition issues. With the resources presently available, we need to make decisions as to how to address the issues in Phase B in a sequential manner.

33. [Sentences omitted from Observer Notes] However, before such work is undertaken, staff think that it would be useful to consider other issues in Phase B, for reasons set out in the following paragraphs.

Staff's Plan

34. Staff's plan is to begin exploring the other topics in Phase B. This work would focus on considering some of the issues of unit of account, recognition and derecognition that might inform the development of the asset and liability definitions. Also, we would focus on considering those issues that seem most likely to inform several current standards-level projects.

35. Staff think that it would be useful to consider other issues in Phase B before finalising the asset and liability definitions, for reasons set out in the following paragraphs.

36. *Some of the unresolved cross-cutting issues in the definitions cannot be fully resolved without commencing consideration of unit of account, recognition and derecognition*. For example, considering unit of account issues will help to identify what the "thing" is that is a candidate for meeting the definitions. As another example, consideration as to how to take into account uncertainty as to the existence of an asset or liability requires consideration of both definitional and recognition issues. As well, those issues that relate to circumstances that might appear to involve both assets and liabilities, such as the distinction between an

impairment and a liability, cannot be resolved without considering the unit of account. (See the status of cross-cutting issues in the Appendix to this paper for further information.)

37. *We cannot finalise the definition of a liability until we have considered the boundary between liabilities and equity*. This is an issue that the Boards have decided to defer until we receive comments on the forthcoming Discussion Paper on that topic. We will be unlikely to be in apposition to return to this until mid-2008.

38. *The thinking developed in considering unit of account, recognition and derecognition might help us in finalising the definitions of an asset and a liability and might help find answers to disputed pieces and point out how to modify parts of the proposed working definitions.* For example, in considering the boundaries between business opportunities and assets and business risks and liabilities we need to consider both definitional and recognition issues.

39. *Many of the reviewers from our informal consultation on the definition of an asset had difficulty considering the definitions without considering unit of account, recognition and derecognition, and perhaps other concepts (some suggested measurement). Some Board members have expressed similar concerns.* By beginning to consider some of those other concepts, we would be able to provide more clarity for reviewers to assess the possible effect the working definitions may have on which assets and liabilities would or would not be recognised or derecognised, as well as what is the thing to be accounted for as an asset or liability.

40. *Considering some of the unit of account, recognition and derecognition issues at a conceptual level will increase the likelihood of greater consistency in decisions at the standards-level.* Several standards-level projects are considering issues presently that relate to those being considered in Phase B. For example, unit of account, recognition and derecognition issues are being considered in the joint leases and revenue recognition projects and issues of unit of account were set aside in recent work on fair value measurements (see SFAS No. 157 and the related IASB Discussion Paper). Also, the staff research project on derecognition is considering issues of derecognition and unit of account that are directly related to the cross-cutting issues in Phase B. [Sentences omitted from Observer Notes]

41. Until we move on to consider some of these other issues, we cannot be sure whether the proposed improvements to the definitions will help. We might find also that some of our earlier thinking requires reconsideration. Accordingly, staff think it likely to be more efficient to consider these issues before trying to finalise the working definitions.

42. All Phase B issues ultimately must be addressed. Staff think that, in the long run, it will be more efficient to proceed to consider unit of account, recognition and derecognition issues at this time [Phrase omitted from Observer Notes].

Proposal

43. We plan to set aside, temporarily, direct consideration of the remaining asset and liability issues and begin consideration of the cross-cutting issues dealing with unit of account, recognition and derecognition.

44. ***Are there any issues dealing with the definitions of an asset and liability that you think must be dealt with*** **now*****, before considering unit of account, recognition and derecognition? If so, what are they and why must they be considered now?***

APPENDIX A

Current Status of Cross-cutting Issues

The following lists the cross-cutting issues identified and the current status of their resolution.

Assets

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

Response: An asset requires that there be both a present right (or other privileged access) *and* a present economic resource. Thus, rights *and* resources are necessary.

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

Response: In the proposed working definition the word *control* is replaced by the more precise term, *rights* (or other privileged access). Privileged access to a present economic resource results in an asset. Thus, if an entity has privileged access to a pool of people to renew insurance policies, perhaps because they are existing customers, and has an economic resource, there is an asset. In this case, the asset is a form of customer relationship—not the future insurance profits. The future insurance profits are not a present economic resource.

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

Response: Rather than control, the definition focuses on rights (or other privileged access). An entity has rights to economic resources, which are things that are capable of producing net cash inflows to the entity or a reduction in net cash outflows from the entity. The economic resource is the thing that exists (a *stock*), rather than the future economic benefits (a *flow*).

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 the counterparty chooses to pay then those payments are made to the entity.

Response: The focus is on rights (or other privileged access) rather than on control or compel. If an entity has rights or other privileged access it should be capable of obtaining the net positive value associated with the economic resource.

EL5: Which future economic benefits are included—where does the asset end?

Response to date: This issue includes considering the boundary between an asset and a business opportunity (related to considering the boundary between a liability and a business risk), and the effect of renewal and cancellation options in determining what the asset is. On the first item, refer to paragraph 16 of this paper for the status of the work being done. The second item is scheduled for discussion later in conjunction with unit of account issues—i.e., when we are trying to identify a particular asset, what related things do we also include in that asset? **Incomplete.**

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

<u>Response:</u> The linkage between an entity and the economic resource is established in the asset definition. The asset definition associates an asset with the entity, to focus on those "good things" that an entity has a right to.

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

<u>Response:</u> The definition of an asset focuses on identifying all of those real-world economic phenomena that exist and are linked to the entity. For practical reasons, some things that meet the definition of an asset, nonetheless, might not be recognised. That is an issue for consideration later in this phase of the project.

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

<u>Response:</u> In the proposed working definition, this question becomes less significant. If the essential criterion is whether an entity has a *present* right to a *present* economic resource then consideration as to what the event is that gave rise to that present right and present economic resource is not essential to the definition of an asset.

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

<u>Response:</u> 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 production, and exchange. Accounting assets are also assets that are associated with a particular entity or entities, while economic assets refer to assets any entity would find beneficial. Sometimes, we might be uncertain whether economic assets exist, but, nonetheless, we might recognize and accounting asset.

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

<u>Response:</u> The proposed asset definition includes those assets to which another is standing ready to provide the entity.

EL10: Why is internally generated goodwill not recognized—does this relate to the asset definition or recognition criteria?

<u>Response:</u> 'Internally generated goodwill' that can be demonstrated to be presently capable of producing net cash flows, or reducing net cash outflows, and to which the

entity presently has rights or other privileged access, meets the definition of an asset. Recognition will be considered later in this phase of the project.

EL11: Options over assets:

a. Which is controlled, the option or the underlying asset?

b. If it is concluded that the option gives control over the underlying asset, should the entity recognize a liability to pay the exercise price? Is there an obligation prior to exercise of the option?

c. Is there asymmetry between definitions of assets and liabilities—that is, does the answer to these questions hold equally for the option writer?

<u>Response:</u> The asset is the entity's present right to the contractual promise to deliver the subject matter of the contract if the option is exercised, rather than a right to the subject matter itself. (Having reached this conclusion, issue b. is not applicable.) The option writer has a liability, represented by its present obligation to stand ready to honour the contract.

EL.12: The role of *probable* or *expected* in the definition of elements, [recognition criteria and measurement][3]. 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?

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)?

<u>Response:</u> Assessing the likelihood of the flow of economic resources to or from the entity has no role in the proposed working definition, so a, b, and c are not pertinent.

EL.13 When do we report what is expected to occur, instead of what a contract requires?

<u>Response:</u> In order to have an asset, a *present* economic resource and *present* rights or other privileged access are necessary. *Expected* economic resources, or economic resources to which an entity *expects* to obtain rights or other privileged access are not *present* economic resources or rights or other privileged access. Thus, they are not assets.

EL.14 What if whether *any* economic benefits flow to or from the entity depends upon the occurrence (or non-occurrence) of a future event that may or may not occur? Does it

[3] 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.

make a difference whether or not the entity has some control over the occurrence of that future event?

Response: Conditional promises do not give rise to assets. However, unconditional promises might be associated with those conditional promises. Thus, an entity can have an asset representing the unconditional promise of another party to stand ready to act or perform if a future event occurs. The entity must have rights or other privileged access to the promise. However, it does not make any difference to the existence of an asset whether the entity has some control over the occurrence of the future event. Such control might affect the likelihood of there being a future benefit. However, likelihood has no role in the definition of an asset.

Liabilities

EL.15 Notion of stand-ready obligations—does this help resolve these questions? Do we need this notion—have we correctly defined the liability?

Response: The stand-ready obligation/liability is a useful notion to describe situations where an entity is obligated to bear an unconditional promise that is associated with a conditional obligation. The notion is also useful from an asset perspective where an entity has an unconditional promise that is associated with a conditional right to receive something.

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

Response: The working definition emphasizes the need for a *present* obligation and a *present* economic burden, rather than a past transaction or other event. If there is a present economic burden and a present obligation, some past transaction or other event must have given rise to it. It would be superfluous for the definition also to include a requirement for there to have been a past transaction or other event.

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

Response: The working definition emphasizes that economic burdens include those that are capable of reducing cash inflow, in addition to those that are capable of resulting in cash outflows.

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*)?

Response to date: Liabilities are limited to those that would be legally or equivalently enforceable. Consideration as to what constitutes "equivalently" is **incomplete**.

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

Response: No—economic compulsion cannot give rise to a present obligation. It is necessary for another party to compel the entity or be capable of enforcing an economic burden upon the entity—an entity cannot compel itself.

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

Response: Both are necessary. The working definition requires both a present obligation and a present economic burden.

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

Response: The working definition requires both a present obligation and a present economic burden. Thus, the sacrifice/burden and obligation are separate. If there is any capability of future cash flows (or a reduction of future cash inflows), then there is an economic burden. If that capability presently falls on the entity, then there is a present obligation. Therefore, the answer is "no"—a liability exists whenever an entity cannot avoid future cash outflows (or reduced cash inflows).

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

Response to date: Only consider net position if unavoidable consequence is to create asset(s). A requirement to replant forests results in a present obligation to do something capable of a cash outflow, but no present right to something capable of generating a future cash inflow. Indeed, the future cash inflow might be so far in the future that its present value is much smaller than the present liability. If the entity were to be immediately better off—perhaps as a result of an obligation to remediate an open pit by filling it with water and creating a lake, which in turn creates saleable waterfront that is worth more than the cost of remediating the open pit—then there is no sacrifice of economic benefits and, hence, no liability. This is, at least in part, a unit of account issue. Therefore, final analysis is **incomplete**.

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

Response to date: An impairment of an asset arises when the "obligation to clean-up" is a direct and unavoidable consequence of generating cash inflows from the asset—i.e., the cash inflows from the asset are reduced. Otherwise, the "obligation to clean-up" gives rise to a liability. This is, at least in part, a unit of account issue. Therefore, final analysis is **incomplete**.

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

Response: No. But a *present* commitment to pay in the future might exist and if so does give rise to a present obligation to an economic burden (a liability). We avoid using the term *future commitment*.

Cross-cutting issues for parts of Phase B not yet commenced

Liabilities and equity

EL25: Should there be a distinction between liabilities and equity?

EL26: Should there by only two elements, e.g., why not three – debt, equity and "dequity."

EL27: How to distinguish liabilities and equity, e.g., shares puttable at fair value.

EL28: Should all elements be defined (if so, will anything fall through the cracks between the definitions) or should one be a residual, (if so, which one)?

EL29: Should equity (once determined) be divided into various sub-classes (e.g., reporting of parent and non-controlling interests – investor's perspective as well as issuer's)? If so, is that division for presentation purposes only, or does it have broader implications?

EL30: Should minority interests be part of equity?

EL31: If settle in own shares (or other equity instrument) – can entity have gains or losses from transacting in own equity instruments?

Unit of Account

EL32: Level of aggregation or disaggregation.

EL33: Basis for aggregation, e.g., type of asset/liability or risk?

EL34: Should an entity recognise assets and/or liabilities for contracts that are still fully executory? If so, what are the assets and liabilities and should the entity report them separately or net them?

EL35: Other gross versus net issues, e.g., securitisation, sale of assets (e.g., revenues versus gains when reporting sales of inventory versus fixed assets)

EL36: Should measurement reflect the effects of synergies, volume discounts, blockage factors, or the "law of large numbers"?

EL37: Is the level of aggregation entity-specific (e.g., size of portfolio entity holds)

EL38: Should “related” transactions be accounted for together, or what is the thing that we are accounting for?

EL39: How about “*un*linkage”?

Other elements

EL40: Comprehensive income versus “net income”; recycling; unrealised versus realised.

Recognition

RC1: What is the recognition event? E.g., if an asset or liability does not meet recognition criteria when acquired or incurred, what event causes the asset or liability to be recognised at a later date?

RC2: Do recognition criteria change depending on the measurement attribute selected?

RC3: Should recognition depend on the reliability of measurement?

Derecognition

RC4: Is it the opposite of recognition (i.e., derecognise when no longer meet criteria for recognition) or does history matter?

RC5: Do we apply concept of legal ownership or control versus risks or rewards?

APPENDIX B

Working draft of the Definition of a Liability

1. The following draft definition of a liability demonstrates that it is possible to draft a definition that is a near parallel to the asset definition in approach.

A liability is a present economic burden for which the entity has a present obligation.

a. *Present* means that both the economic burden and the obligation exist on the date of the financial statements.

b. An *economic burden* is something that has negative economic value. It is capable of requiring the sacrifice of economic resources. An economic burden can result in cash outflows or reduced cash inflows, directly or indirectly, alone or together with other economic burdens. Economic burdens include non-conditional contractual promises that the entity makes to others, such as promises to pay cash, deliver goods, or render services. Rendering services includes standing ready to perform or refraining from engaging in activities that the entity could otherwise undertake.

c. An *obligation* requires the entity to bear the present economic burden directly or indirectly. Obligations are enforceable by legal or equivalent means (such as by a professional association).

2. Using a parallel approach with the asset definition, the liability definition focuses on the *capability* of requiring cash outflows (or reducing cash inflows), rather than on the cash flows themselves that might result.

3. In application, the liability definition does not completely parallel the asset definition because not all assets give rise to corresponding liabilities. Even though "obligation" in the liability definition may be seen as the counterpart to "right or other privileged access" in the asset definition, it does not fully mirror those terms because rights include property rights and other privileged access includes similar items (such as a secret formula) for which there is no corresponding obligation.