



**International
Accounting Standards
Board**

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

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

IASB Meeting: 17 June 2008, London (Agenda Paper 11C)
Project: Conceptual Framework
Phase B: Elements and Recognition – Summary of Tentative Decisions

INTRODUCTION

1. By the end of the June 2008 meetings, the staff plan to have discussed, and sought agreement on, substantially all of the issues to be addressed in considering the definition of a liability, with the exception of those relating to the distinction between liabilities and equity. These latter issues will be discussed only once an initial analysis of comments on the Discussion Paper, "Financial Instruments with Characteristics of Equity," is available. That analysis is expected to be available in October 2008.
2. The staff intend to draft Discussion Paper text on the definitions of an asset and a liability during July and August 2008.

OBJECTIVE

3. The objective of this paper is for Board members to confirm the tentative decisions relating to the definition of a liability that we should use as the basis for that drafting. We would also

appreciate advice from Board members as to any additional matters related to the definition of a liability that they think it necessary be addressed before we commence drafting.

4. Previously, some Board members have suggested additional examples against which we should test our working definition of a liability. Those examples are analysed in Agenda Paper 11D.
5. *Board members are requested to review the following summary of tentative decisions and consider whether they:*
 - a. *agree with the proposed working definition of a liability and the supporting tentative decisions as a basis for drafting. If not, why not; and*
 - b. *think that any additional matters related to the definition of a liability need to be addressed before we commence drafting. If so, what are those matters?*

TENTATIVE DECISIONS REACHED

Proposed Working Definition of a Liability

A **liability** of an entity is a present economic obligation that is enforceable against the entity.

- a. *Present* means that the economic obligation exists on the date of the financial statements.
- b. An *economic* obligation is something that is capable of resulting in cash outflows or reduced cash inflows, directly or indirectly, alone or together with other economic obligations.
- c. Obligations link the entity with what it has to do because obligations are *enforceable* against the entity by legal or equivalent means.

In support of, this definition, the Boards made the following tentative decisions.

A liability:

- a. should continue to be defined directly, with reference to assets [February/March 2006];
- b. is the present obligation, not the future sacrifice [February/March 2006, reconfirmed December 2007];

- c. need not include probability or other notions of likelihood, which instead belong, if at all, in recognition criteria or measurement [February/March 2006, reconfirmed December 2007]; and
- d. a liability consists of a *bad thing* and a *link* that binds the entity to that bad thing. Board members preferred to refer to an *economic obligation* to describe the bad thing *and* the link, rather than using two different terms to express the bad thing and the link [December 2007].

A present economic obligation:

- e. exists at the financial statement date [April 2006];
- f. can only have arisen from past events, thus, explicit reference to past events is unnecessary—redundant [February/March 2006, reconfirmed December 2007];
- g. is an obligation to provide economic resources to others, or to stand ready to do so—it is economic [April 2006]; and
- h. can include an obligation to forgo a cash inflow [February/March 2006].

An obligation is enforceable against the entity when:

- i. the entity is obligated to act or perform (or to refrain from acting or performing) [April 2006];
- j. (i) a party separate from the entity is involved [February/March 2006, reconfirmed December 2007]; and (ii) a mechanism is available to that party that enables it to force the entity to take a specified course of action [December 2007]. These are the essential attributes of an enforceable obligation; and
- k. there is legal or other equivalent compulsion.¹ This notion replaces the reference in the current definition to little or no discretion to avoid a future sacrifice [February/March 2006]. Thus, an equitable or constructive obligation can be a liability if it legally or equivalently compels potential outflows of cash or other potential sacrifices (or reduced cash inflows or other reduction of benefits) [February/March 2006].

¹ Does not include economic compulsion.

Distinguishing a liability from a general risk

- l. A present economic obligation is an essential characteristic of a liability, but not a general risk [March 2007 (IASB) & May 2008 (FASB)].
- m. A present economic obligation exists when:
 - (i) an entity is committed to a particular action(s) that is capable of resulting in cash outflows, and
 - (ii) there is a mechanism to enable that economic obligation to be enforced against the entity [March 2007 (IASB) & May 2008 (FASB)].
- n. Laws and regulations are examples of mechanisms and are not, by themselves, present obligations [March 2007 (IASB) & May 2008 (FASB)].

Types of obligations

- o. It is helpful to analyse contracts and other binding agreements to identify whether they contain unconditional and conditional obligations. An *unconditional obligation* requires performance to occur now or over a period of time, whereas a *conditional obligation* requires performance to occur only if an uncertain future event occurs. In situations where a conditional obligation is identified, it can be helpful to assess if there is an accompanying unconditional obligation that presently requires the entity to perform. Non-contractual scenarios, as well as contractual scenarios, can be analysed to identify unconditional and conditional obligations [March 2007 (IASB) & May 2008 (FASB)];
- p. It would be preferable to describe these situations in terms of their unconditional and conditional components [March 2007 (IASB) & May 2008 (FASB)].

- 6. Does the Board agree with the proposed working definition of a liability and the summary of tentative decisions as a basis for drafting? If not, why not?**
- 7. Are there any additional matters related to the definition of a liability that the board thinks we need to address before we commence drafting? If so, what are those matters?**