STAFF PAPER

May 2014

REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Elements of financial statements: definitions of asset and liability		
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Purpose of paper

1. This paper discusses the definitions of an asset and a liability.

2. This paper does not address:

   (a) recognition (see Agenda Paper 10B);

   (b) the approach to defining income and expense (see Agenda Paper 10C);

   (c) the distinction between equity and liabilities, and possible implications for the definition of a liability. This will be the subject of future papers;

   (d) supporting guidance on the following issues, which will be the subject of future papers:

      (i) the notion of control: whether to retain it, in either the definition of an asset or in recognition criteria, and how to define control. Also, implications of control for agents and principals;

      (ii) economic resources and economic benefits;

      (iii) obligations, and past events (including obligating events);

      (iv) executory contracts;

      (v) reporting the substance of contractual rights and obligations;

      (vi) unit of account.

Summary of recommendations

3. The staff recommend in this paper that the IASB should:

   (a) confirm the following definitions, which are the same as the definitions proposed in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, with one exception noted in (b) below:

      (i) Asset of an entity: a present economic resource controlled by the entity as a result of past events;

      (ii) Liability of an entity: a present obligation of the entity to transfer an economic resource as a result of past events;

      (iii) Economic resource: a right that is capable of producing economic benefits.

   (b) delete the phrase 'or other source of value' from the definition of an economic resource that was proposed in the Discussion Paper.

Structure of paper

4. This paper is structured as follows:

   (a) Background (paragraph 5)

   (b) Overall feedback on the changes suggested in the Discussion Paper (paragraphs 6–15)

   (c) Feedback on specific aspects of the definitions (paragraphs 16–61)

   (d) Other matters (paragraph 62)

   (e) Other suggestions received (Appendix A)

   (f) Public sector (Appendix B)

Background

5. As shown in table 1, the Discussion Paper suggested changing the definitions of an asset and of a liability to confirm explicitly that:

(a) an asset (or a liability) is a resource (or obligation), rather than the ultimate inflow (or outflow) of economic benefits that the resource (or obligation) may generate.

(b) an asset (or a liability) must be capable of generating inflows (or outflows) of economic benefits. Those inflows (or outflows) need not be certain.

Table 1 definition of an asset and a liability

	Existing Conceptual Framework	*Discussion Paper*
Asset	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	a present economic resource controlled by the entity as a result of past events
Liability	a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits	a present obligation of the entity to transfer an economic resource as a result of past events
Economic resource	-	a right, or other source of value, that is capable of producing economic benefits

Overall feedback on the changes suggested in the Discussion Paper

6. Many respondents agreed with the suggested changes to the definitions of an asset and of a liability. Many others agreed with the direction of the amendments, but suggested refinements. Some respondents disagreed with the changes.

7. More specifically:

(a) Most respondents agreed that the definitions should focus more on the resource or obligation than on the future flows of economic benefits that might result.

(b) Many respondents also agreed with the proposal to replace the notion that future inflows or outflows of economic benefits must be 'expected'. However, several respondents opposed this proposal. Several other respondents would agree with this change, but only if the recognition criteria include an explicit criterion relating to probability (uncertainty). Agenda paper 10B discusses recognition criteria.

8. Few users commented explicitly on the definitions, and they did not generally express strong views. Some found the revised definitions clearer. Some commented on assets or liabilities with a low probability of inflow or outflow: they expressed concerns about recognition of these items. Some opposed recognising these items, but felt that including them within the definitions might lead to useful disclosure.

9. Respondents who agreed with the suggested changes made the following comments:

(a) The proposed definitions are clearer and easier to understand than the current definitions. They are more precise, more concise and focused, and less cumbersome, and show more clearly the parallel between an asset and a liability. They are likely to result in more consistent interpretations.

(b) Removal of 'expected' appropriately focuses the definition on the resource and the capability of the resource (rather than future expectations).

(c) The new definition is better suited to make room for considering intellectual property and other intangibles as assets. Those who made this comment may have done so mainly because of the inclusion of the phrase 'other source of value', which is discussed later in this paper.

(d) The new definitions would make it clearer that regulatory assets and regulatory liabilities qualify as assets and liabilities.

(e) The proposed definitions more accurately reflect how the IASB has used the existing definitions.

10. A few respondents stated that there was no need to change the existing definitions. They made the following comments:

    (a) The existing definitions are well accepted and have not created confusion or major problems for preparers or users.

    (b) Applying the existing *Conceptual Framework*, there was no doubt that the asset is the resource (and not the expected flows of economic benefits) in any of the examples provided in paragraph 2.14 of the Discussion Paper.

    (c) The proposed definitions do not differ from the existing definitions sufficiently to warrant the change.

    (d) The changes replace some notions (such as 'expected') with others (such as 'capable') that will be no better understood.

11. Many respondents stated that the new definitions are broader than the existing definitions. They expressed concerns that the broader definitions would:

    (a) together with the move to viewing assets as bundles of rights, put more pressure on the recognition criteria.

    (b) increase the workload for preparers.

12. Throughout the outreach, and in the comment letters, many asked the IASB to clarify whether it intended that the proposed definition would:

    (a) together with the proposed approach to recognition, increase or decrease the range of assets and liabilities recognised.

    (b) lead to disclosure about a wider range of any assets and liabilities that remain unrecognised.

13. Several respondents viewed the proposed changes as more than just clarifications. They asked the IASB to carry out further testing to assess whether the proposed definitions of an asset and of a liability:

    (a) would be interpreted and applied consistently. Some suggest that the IASB should test the consistency of interpretations by publishing for comment a list of items it considers meet the proposed definitions.

    (b) accord with what users and preparers consider to be assets and liabilities.

(c) would, together with the proposed approach to recognition, derecognition, measurement and presentation, result in useful information and provide operational solutions. Many commentators reported that they found it difficult to assess the suggestions in the Discussion Paper without having an indication of their overall effects.

Staff analysis

14. In the staff's view:

(a) the definitions proposed in the Discussion Paper are consistent with how the IASB has applied the existing definitions in practice for several years. Indeed, some respondents also made that point.

(b) the IASB did not intend the new definitions to be understood either more broadly or more narrowly than how the IASB understands the existing definitions.

(c) by clarifying how the IASB understands the existing definitions, the new definitions will provide a basis for a clearer and more productive dialogue with respondents to future proposals.

15. If the Exposure Draft of the revised Conceptual Framework clarifies that the IASB did not intend to broaden or narrow the definitions of an asset and a liability, the staff believes it may not be necessary to provide examples of items that meet the definitions and of items that do not meet the definitions. It may also be helpful to refer respondents to the *Illustrative Examples on IFRS 3 Business Combinations*. These contain extensive examples of items that meet the existing definitions, in the light of the related guidance in IFRS 3. In drafting the Exposure Draft, the staff will consider whether to refer specifically to any of those examples.

Feedback on specific aspects of the definitions

16. Respondents commented on various aspects of the definitions of an asset and of a liability:

(a) economic resource (paragraphs 18–25)

(b) focus on rights (paragraphs 26-30)

(c) other source of value (paragraphs 31–40)

(d) deleting the notion of an expected inflow or outflow (paragraphs 41-52)

(e) past event (paragraphs 53–61)

(f) other suggestions by commentators (Appendix A)

17. Respondents also commented on the notions of control and obligation, and on various aspects of the supporting guidance included in the Discussion Paper. The staff plan to discuss these topics in papers for future meetings.

Economic resource

Background and feedback

18. The main structural change in the proposed definition was the proposal to introduce a separate definition of an economic resource. This repositions the references to future flows of economic benefits so that they appear in the supporting definition (of an economic resource), rather than in the definitions of an asset and of a liability.

19. As noted above, most respondents supported the direction of the proposed changes to the definitions. Some respondents stated explicitly that they favoured the introduction of this separate definition. They stated that it:

(a) enhances the clarity and succinctness of the definitions.

(b) emphasises the parallel between the definitions of an asset and of a liability.

20. A few commentators objected to creating a separate definition. They argued that readers should be able to understand what an asset or liability is without having to look up other definitions.

21. Some respondents made other suggestions on economic resources:

(a) The concept of ‘economic resource’ is defined using two terms ‘economic benefits’ and ‘value’ that remain undefined. Hence, the proposed definitions do not enhance clarity or add new insights.

(b) Because the definition of an economic resource refers in turn to future economic benefits, an asset should be defined as those future economic benefits, not as economic resource itself. What gives the resource value is the possibility of future inflows.

(c) The term ‘economic resource’ is too limiting and for some suggests only resources that have a market value. A preferable term is ‘resource’, which could include resources that are financial, tangible, intangible or human.

(d) The IASB’s *Conceptual Framework* is applied in some jurisdictions in the public sector, not-for-profit, and non-capital market settings. Therefore, the definition of an asset should include resources that provide benefits other than cash flows, such as social or environmental services or benefits to the reporting entity, to other parties or to wider society. Similarly, the definition of a liability should include obligations to transfer such benefits, and obligations entered into for prudential or moral purposes, or entered into to meet expectations of a broader group of stakeholders, or to maintain public support.

Staff analysis

22. For the following reasons, the staff still recommend placing the reference to future economic benefits in a supporting definition (of economic resource), rather than in the definitions of an asset and of a liability:

(a) This separation emphasises more clearly that an asset (or a liability) is a resource (or obligation), rather than the ultimate inflow (or outflow) of economic benefits that the resource (or obligation) may generate.

(b) This approach streamlines the definitions, and shows more clearly the parallels between asset and liabilities.

23. The staff provide the following comments on other matters raised by respondents, as summarised in paragraph 21:

(a) The term ‘economic benefits’ already appears in the existing definitions of assets and liabilities. The staff has not identified any major problems caused by its use. The staff recommends retaining it. The term ‘value’ appears in the phrase ‘other source of value’, which is discussed in paragraphs 31-40.

(b) Although an asset derives its value from its capacity to generate future benefits, the thing that the entity controls today is that existing capacity, not the future economic benefits. Also, defining an asset as the possible future benefits would make it unclear (i) whether an asset exists if the possible future benefits are uncertain and (ii) which possible future economic benefits qualify as assets at any given date. Therefore, the definition of an asset should continue to refer to the (economic) resource, not to the resulting economic benefits.

(c) The existing definition of an asset already uses the term ‘resource’. The Discussion Paper proposed replacing that term with the term ‘economic resource’. That helps to emphasise that the resource in question is not, for example, a physical object, but rights over a physical object. The term ‘economic resource’ is not intended to be limited to resources for which a market currently exists. It covers all resources that are capable of generating economic benefits.

(d) The IASB focuses currently on for-profit entities. Thus, the definition of an asset should continue not to refer to resources that provide benefits other than economic benefits, such as social or environmental services or benefits to the reporting entity, to other parties or to wider society.

24. An agenda paper for a future meeting will discuss possible guidance on economic resource and economic benefits.

Question 1 Separate definition of economic resource
Does the IASB agree that the reference to future economic benefits should be placed in a supporting definition (of economic resource), rather than in the definitions of an asset and of a liability?

25. The following paragraphs discuss two aspects of the definition of an economic resource:

    (a) The focus on rights (paragraphs 26–30)

    (b) Other sources of value (paragraphs 31–40)

Focus on rights

Background

26. The term ‘resource’ already appears in the existing definition of an asset. The Discussion Paper used the amended term ‘economic resource’, and suggested defining an economic resource (and, hence, an asset) as a right. To illustrate the effect of this change in emphasis from ‘resource’ to ‘right’, paragraph 3.7 of the Discussion Paper suggested that, for a physical object, such as an item of property, plant and equipment, the economic resource is not the underlying object but a right (or a set of rights) to obtain the economic benefits generated by the physical object.

27. Paragraphs 3.8-3.11 of the Discussion Paper provided further discussion of this notion:

    (a) If an entity has legal ownership of a physical object, the economic resource comprises rights such as the right to use the object, the right to sell the object; the right to pledge the object and any other rights conferred by legal title.

    (b) In many cases, one party holds all these rights. Sometimes, as in a lease, each different parties control the rights. In those cases, the IASB would need to decide how each party accounts for the rights it controls.

    (c) In many cases, an entity treats all of the rights it controls as a single asset. Nevertheless, an entity would treat some of the rights as one or more separate assets if such a separation produces information that is relevant to users of financial statements and provides a faithful representation of the entity’s economic resources, at a cost that does not exceed the benefits of doing so.

(d) An entity should describe an economic resource in a manner that is clear, concise and understandable. For example, if an entity has legal ownership of a machine and all rights associated with that machine, strictly speaking the entity's asset is the bundle of all rights associated with that machine. However, it would generally be perfectly clear, concise and understandable to describe the entity's asset as a machine, rather than as rights to a machine. More detailed and sophisticated descriptions of the asset would be needed only in less common circumstances in which a summarised or non-technical description would not convey the nature of the asset. Furthermore, it would typically be preferable, to use a concise label on the face of the statement of financial position, providing any necessary details in the notes.

Feedback

28. A few respondents commented explicitly on the rights approach. Some of them agreed with the focus on rights, whereas others disagreed. Respondents who agreed with the approach suggested in the Discussion Paper said that:

(a) Defining an 'economic resource' as 'a right, or other source of value, that is capable of producing economic benefits' would confirm a shift away from traditional notions of accounting for physical objects and toward accounting for different rights composing economic resources. This shift should be particularly helpful over time in addressing derecognition of components of assets (eg non-financial assets).

(b) A move to 'rights' is not without precedent. As long ago as 1907 Charles Ezra Sprague wrote 'every asset may be looked upon either as a "thing" or a "right". Possession of a thing is merely the right to use it and control it.' Slightly more recently, the UK ASB's *Statement of Principles for Financial Reporting* (1999) contains the following definition of an asset: 'Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions and events'. This definition has proved useful in developing standards, for example FRS 5 *Reporting the Substance of Transactions*.

(c) Since a familiar asset - such as property, plant and equipment - is represented in law by a bundle of rights, in accounting terms each component right in the bundle may be a separate asset. So although they may be presented together for convenience (eg as property, plant and equipment) in the balance sheet, the asset is not the physical object, and, indeed, there may not be one asset but many. There is a good deal of logic in this view: many transactions seek to carve out or create component rights to financial instruments, intangible assets and even tangible assets.

29. Respondents who disagreed with the focus on rights stated that:

(a) An asset should be defined as a right (or bundle of rights) or resource, not just as a right. Some assets are best described as resources, rather than rights. For example, the notion of rights is better suited to intangible assets than to tangible assets. The concept of accounting for tangible assets as a set of rights is not consistent with reality, especially when combined with the idea of 'unbundling' rights from an asset. A tangible asset is not a right but rather a source of value, used in a business.

(b) Unless the notion of unit of account is explicitly explained in the Conceptual Framework, it would be difficult to explain consistently, for a single asset comprising several rights, whether to recognise that single asset as a whole or to recognise some of those rights separately. That explanation should discuss what factors drive componentisation.

(c) The move to a rights approach would put more pressure on the recognition and derecognition criteria, and on the unit of account. Entities would need to ask themselves numerous questions in order to determine or deny the existence of new assets and liabilities, without any clear benefit. Indeed, the rights approach has previously caused some challenges in developing new standards (eg the recent project on leases) and in applying existing standards that follow this approach, particularly when considering the implications for derecognition (eg for financial instruments).

(d) If the IASB persists with the property rights approach, then specific references to economic literature are necessary to add assurance that the Conceptual Framework is applying this notion appropriately.

Staff analysis

30. In the staff's view:

(a) For the following reasons, there is no advantage in creating two separate classes of assets, one described as a resource (eg in cases of full legal ownership of a physical object) and the other described as a right (all other rights over all or part of a resource):

(i) many assets (such as financial assets, a lessee's rights of use of a leased machine, and many intangible assets, such as patents) are rights that are created by contract or by law. However, it is equally true that ownership of a physical object arises only because of rights conveyed by law. These different types of right differ only in degree, not in nature.

(ii) for a physical object, full legal ownership provides the most extensive set of rights. However, that set of rights differs only in extent and degree, but not in nature, from a slightly less extensive set of rights (eg a right to use the object for 99 per cent of its useful life) or a much less extensive set of rights (eg a right to use the object for 50 per cent, or ten per cent or even one per cent of its useful life). In all these cases, the holder has a set of rights. One end of the spectrum (full, unencumbered legal ownership) is qualitatively no different from every other point on the spectrum.

(iii) because of legal differences or legal changes, a particular bundle of rights may constitute full legal ownership in one jurisdiction but not in another jurisdiction, or at one date but not at another date. A faithful representation would not result from applying one treatment to one bundle of rights that constitutes full legal ownership but a different treatment to an identical bundle of rights that, in a different jurisdiction or at a different date, does not constitute full legal ownership.

(b) an entity should describe an economic resource in a manner that is clear, concise and understandable. For example, if an entity has legal ownership of a machine and all rights associated with that machine, it would generally be perfectly clear, concise and understandable to describe the entity's asset as a machine, rather than as rights to a machine. More detailed descriptions of the asset would be needed only in less common circumstances when a summarised or non-technical description would not convey the nature of the asset.

(c) in many cases, an entity should treat a bundle of rights as a single asset. Nevertheless, an entity should separate a bundle of rights into components if such separation is needed to produce information that is relevant to users of financial statements and provides a faithful representation of the entity's resources, at a cost that does not exceed the benefits of doing so.

Question 2 Focus on rights
Does the IASB agree that assets should be viewed as rights, or bundles of rights, rather than as underlying physical or other objects?

Other source of value

Background

31. As noted above, the Discussion Paper's proposed definition of an economic resource included not only 'rights', but also 'other sources of value' that are capable of producing economic benefits. Paragraph 3.5(c) of the Discussion Paper suggested that examples of such 'other sources of value' are know-how, customer lists, customer and supplier relationships, an existing work force and goodwill.

Feedback

32. Few respondents commented explicitly on 'others sources of value'. Most who commented on this phrase indicated that it does little to place boundaries around the concept and provides opportunities for wide interpretations in practice.

33. Other respondents expressed concerns about some of the items listed in paragraph 3.5(c) of the Discussion Paper:

    (a) Know-how and customer lists may be assets. They enable the entity to do something advantageous (eg manufacture a product or carry out a targeted marketing exercise). However, the remaining items seem more doubtful. For example, a customer relationship does not give rise to a right to future business, only to the hope of future business and it would be difficult to be sure that any such business will be on more advantageous terms because of the relationship.

    (b) A company's workforce, fundamental research and the ability to raise prices or to reduce a liability in the future, all appear to meet the proposed definition of assets but should continue not to be recognised or, if recognised, should be measured at nil. Some suggested that the definition of an asset should include notions such as identifiability or separability, as in the treatment of intangible assets in IAS 38 *Intangible Assets*.

    (c) Although the IASB concluded in IFRS 3 that goodwill is an asset, the rationale is not convincing. Goodwill by itself is incapable of producing economic benefits and relies on the cash generating abilities of other assets. Moreover, the amount attributed to goodwill includes amounts relating to other unrecognised assets and liabilities.

Staff analysis

34. In some instances, an item is capable of generating economic benefits for an entity, and the entity controls the item by having the power and practical ability to prevent other parties from deriving economic benefits from that item, even though another party could not be compelled to pass over any economic benefits that it captures. For example, an entity might control know-how by keeping in secrecy know-how that is not protected by a patent. As long as the entity keeps that know-how secret, it can

prevent other parties from deriving benefit from the know-how. However, if another party obtains the know-how, the entity might not be able to prevent the other party from using the know-how.

35. The Discussion Paper included in the definition of an economic resource the notion of ‘other sources of value’, because of concerns that the notion of a ‘right’ might not be broad enough to capture such cases.

36. In the light of responses to the Discussion Paper and feedback received during outreach, the staff:

    (a) still believes that the definition of an asset should capture know-how that is capable of generating economic benefits, even if the only means of controlling the know-how is by keeping it secret, rather than by means of legal rights.

    (b) now thinks that the notion ‘other source of value’ is too vague to be useful in a formal definition.

37. The last two sentences of paragraph 4.12 of the existing *Conceptual Framework* state:

> Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.

38. The staff believes that wording along these lines would explain that the notion of a ‘right’ encompasses a right to know-how controlled by keeping the know-how secret. The wording would need some change:

    (a) to replace the notion of an entity’s ‘capacity to control benefits’. The entity controls its rights to the know-how, rather than controlling the future economic benefits that the know-how may generate.

    (b) to replace ‘legal control’. Control refers here to the mechanism (legal or other) that enables the entity to enforce its right.

(c) to clarify that if the know-how generates any economic benefits, the entity is the party that will receive them. A similar idea appeared in paragraph 3.27 of the Discussion Paper.

39. The following is possible wording reflecting these points:

> Although an asset is usually a legal right, a right may nonetheless satisfy the definition of an asset even when the only way to enforce that right is using a mechanism other than the law. For example, know-how obtained from a development activity may meet the definition of an asset when an entity controls that know-how by keeping it secret and so ensuring that the entity is the party that will receive any economic benefits that flow from it.

40. The wording in the previous paragraph gives only one example (know-how). Paragraph 33 summarises concerns raised by respondents about some other items. The staff will review those concerns in a future paper that discusses the feedback received on the Discussion Paper's suggested guidance supporting the notions of economic resource and economic benefits.

Question 3 Other source of value
Does the IASB agree to delete the notion 'other source of value' from the definition of an economic resource that was suggested in the Discussion Paper? The guidance supporting the definition of an economic resource should confirm that the notion of a 'right' is broad enough to capture know-how that is controlled by keeping it secret.

Deleting the notion of an expected inflow or outflow

Background and feedback

41. As noted above, the Discussion Paper suggested replacing the notion that an inflow or outflow of resources is *expected* with the notion that an asset (or liability) is *capable* of generating economic benefits (a transfer of economic resources).

42. Many respondents agreed with that suggestion. They made the following comments:

(a) Removal of ‘expected’ appropriately focuses the definition on the resource.

(b) To retain a notion of expected or probable outflows or inflows would exclude many items that are clearly assets and liabilities, such as written and purchased options, stand-ready obligations and insurance contacts.

(c) The notion of ‘expected’ is unhelpful, as interpretations of this term can vary widely and are often tied to a notion of a threshold level of probability.

(d) Matters of uncertainty that underlie valuation are best dealt with in recognition criteria or in measurement rather than within the definitions.

(e) There is little merit in the argument that removing the probability criterion will require considerable effort to identify assets and liabilities that will not be recognised. In practice, potential recognition will be in focus from the very beginning.

(f) If an entity has some opportunity that is not certain to produce economic benefits, but is capable of doing so, users do not wish the entity to recognise an asset. Nevertheless, such a broader definition of an asset may result in useful information to users if used as a trigger for disclosure rather than for recognition.

43. Other respondents favoured retaining the notion of an expected inflow or outflow of resources. They made the following comments:

(a) Removing that notion considerably widens the range of items that will be identified as assets and liabilities. This may lead to:

(i) pressure to identify every possible asset and liability, imposing a significant operational burden, for little benefit if ultimately the asset or liability is not recognised, or is measured at nil.

(ii) recognition as assets and liabilities of more items that are uncertain, improbable or hard to measure, unless the recognition criteria are made more robust.

(iii) a presumption that, in principle, all assets and liabilities should be recognised even if inflows or outflows are not expected.

(iv) pressure for disclosure about unrecognised assets and liabilities for which inflows or outflows are unlikely.

(b) If the term 'expected' is being interpreted inconsistently or misunderstood, the IASB could clarify how to interpret the term, instead of deleting it.

(c) The proposed threshold for the existence of an asset of 'capable of producing economic benefits' is low and the result is not understandable. Users and preparers do not regard an item as an asset if no inflows of economic benefits are expected. Benefits must be reasonably possible.

(d) Replacing 'expected' with 'capable' merely replaces one difficulty with another. The term 'capable' is subjective and may create ambiguity.

(e) Assessing whether a resource is 'capable of producing economic benefits' relies on the same thought process as assessing whether benefits are expected to flow, but references to expected flows are easier to understand.

(f) For repayable capital contributions of members in cooperatives, it could be misleading to delete 'expected' outflows from the definition of a liability. The repayment of the total share capital is a scenario of little relevance if the cooperative is a going concern.

(g) The word 'expected' removes the need to prove absolute certainty. Deleting that word could lead to a misunderstanding that no liability exists if measurement requires substantial estimation, as for insurance liabilities or major litigation.

(h) Deleting 'expected' may lead to new differences from US GAAP.

44. Some respondents asked the IASB to clarify:

(a) at what point an economic resource that needs to be transformed becomes capable of producing economic benefits. For example, at what point does an information technology project transform the effort of a workforce into software that is 'capable' of producing economic benefit?

(b) whether the notion of 'capable' refers only to outcomes that are consistent with the entity's strategies and intentions, or whether it also refers to outcomes that could occur if the entity's strategies or intentions were different. Some respondents stated that the replacement of 'expected' by 'capable' places too much emphasis on the objective of 'neutrality', to the detriment of an 'entity-specific view'.

(c) that the asset must be capable of producing economic benefits for the entity, and not only for other parties.

(d) whether capable still contains an implicit probability threshold.

45. A few respondents asked the IASB to clarify the meaning of the term 'capable', or replace it, for example by saying that the economic resource 'may' produce future economic benefits. They noted that the term 'capable' appears in the definition of a business in IFRS 3 *Business Combination* and they stated that the term 'capable' in that context makes it difficult to determine whether an acquisition is of a business or of assets.

Staff analysis

46. In the staff's view, the IASB should confirm the Discussion Paper's proposal to delete from the definitions of assets and liabilities the notion that an inflow or outflow is 'expected'. Retaining such a notion might exclude many items that are clearly assets or liabilities, such as many purchased options or written options. Many respondents have significant concerns about recognising assets or liabilities for which the

probability of an inflow or outflow of benefits is low, but those concerns are best addressed in recognition not in the definitions.

47. A few comments received imply that some respondents did not fully understand the following key ingredients in the notion that an economic resource must be 'capable of producing economic benefits':

    (a) It is not sufficient that the economic benefits may arise in the future. Those economic benefits must arise from some feature that already exists within the economic resource. For example, a purchased option is capable of producing economic benefits to the holder, but only because the option already contains a term that will permit the holder to exercise the option.

    (b) The term 'capable' is not intended to impose a minimum probability threshold. The important thing is that there are at least some outcomes in which the economic resource will generate economic benefits.

48. The staff considered whether some phrase other than 'capable of producing' might convey the intended meaning more clearly. Phrases considered included 'has the potential to produce', 'has the capacity to produce'[1] and 'has the capability to produce'. Nevertheless, none of these other phrases would be obviously clearer than 'is capable of producing'. Moreover, any phrase selected would still need to be supported by clarification of the points mentioned in paragraph 47. Accordingly, the staff suggest keeping that phrase and supplying guidance along those lines.

49. The proposed definition of a liability refers to 'a present obligation of the entity to transfer an economic resource as a result of past events'. This definition does not refer explicitly to the notion 'is capable of'. Instead, the supporting guidance says that an obligation must be 'capable of generating outflows of economic benefits'.

50. The staff considered whether to recommend changing the definition of a liability, so that it refers to a present obligation that is 'capable of requiring the entity to transfer an economic resource as a result of past events'. However, the staff think that this would be too cumbersome, and so it is better to rely on supporting guidance, rather than trying to deal with this point explicitly in the definition.

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[1] Paragraph 4.12 of the existing *Conceptual Framework* refers to an entity's 'capacity to control benefits'. That wording is quoted in paragraph 37 of this paper.

51. Agenda paper 10B discusses, among other things, whether the Conceptual Framework should discuss what to do in cases where:

    (a) it is uncertain whether an asset or liability exists (existence uncertainty).

    (b) an asset or liability exists, but it is uncertain whether that asset or liability will ultimately result in an inflow or outflow of economic benefits (outcome uncertainty).

52. In relation to clarifications requested by respondents, as summarised in paragraph 44, the staff's view is as follows:

    (a) It is beyond the role of the Conceptual Framework to give specific guidance on the point at which an economic resource that needs to be transformed becomes capable of producing economic benefits.

    (b) In the definition of an asset and guidance supporting that definition, there is no need limit the notion of 'capable' so that it refers only to outcomes that are consistent with the entity's strategies and intentions. In assessing whether such an asset should be recognised, it would be appropriate to consider whether the resulting information would be relevant to users.

    (c) If an asset were capable of producing economic benefits for other parties, but not for the entity, and if it is not possible, and cannot become possible, to sell the asset, it seems unlikely that recognising the asset would provide users with relevant information.

    (d) As noted above, the term 'capable' is not intended to convey a minimum probability threshold.

Question 4 Capable of generating economic benefits
Does the IASB agree that: (a) the definitions of assets and liabilities should not retain the notion that an inflow or outflow is 'expected'? (b) the definition of an economic resource should, as proposed in the Discussion Paper, specify that an economic resource must be capable of generating economic benefits? The term 'capable' indicates that the economic benefits must arise from some feature that already exists within the economic resource. The term 'capable' is not intended to impose a minimum probability threshold. The important thing is that in at least some outcomes the economic resource will generate economic benefits. (c) The notion 'is capable of' should not appear explicitly in the proposed definition of a liability. The supporting guidance should clarify that an obligation must contain an existing feature that is capable of requiring the entity to transfer an economic resource.

Past event

Background and feedback

53. Paragraph 2.16(b) and(c) of the Discussion Paper suggested that:

    (a) the phrase 'as a result of past events' should remain in both definitions.

    (b) the word 'present' should remain in the definition of a liability and be inserted in the definition of an asset.

54. Several respondents explicitly supported retaining the reference to past events, on the following grounds:

    (a) This reference is important to prevent recognition of items that depend largely on the entity's own future acts, such as future operating losses.

    (b) This reference will focus on the need to identify when and how the obligation was incurred, in order to ensure it is correctly recorded. This is consistent with the historical, largely transactions-based nature of accounting, and responds to an accountability objective.

(c) This reference may be needed to capture items such as a deferred tax liability and post-employment benefits: some believe that the obligation to pay tax or benefits will arise in the future but needs to be recognised now because it arises as a result of past events (for example, service by the employee).

(d) In discussing obligations conditional on the entity's own actions, the Discussion Paper uses the notion of a past event.[2] Thus, this notion must remain in the definition of a liability.

55. Several other respondents opposed the reference to past events, on the following grounds:

(a) The reference is redundant. A present asset or liability cannot exist without a past event. Identifying that past event may help to determine how to portray that event in financial statements, but this point could be explained in the supporting guidance, rather than in the definitions.

(b) The reference may appear to create a requirement to search for, and identify, the past event.

(c) The reference may lead to an excessively strict view of what is necessary to constitute a present obligation, and to counter intuitive accounting, such as the accounting requiring by IFRIC 21 *Levies*.

(d) It is not clear which past events are sufficient to create an obligation. Moving the focus to the present condition would make the definition easier to apply in practice.

56. One respondent suggested that the word 'present' is helpful because some items can change their classification as an asset or liability from one period to another.

57. However, a few respondents objected to the word 'present', on the following grounds:

(a) The reference to past events makes the term 'present' redundant.

[2] Paragraphs 3.65-3.66 of the Discussion Paper

(b) The definitions of an asset and of a liability apply to resources and obligations that exist at the reporting date. Thus, the term ‘present’ is superfluous and confusing.

(c) The word ‘present’ is mentioned explicitly in the definition of an asset and again implicitly in the discussion of ‘control’. The explicit reference in the definition is redundant.

(d) The word ‘present’ might be misunderstood when applied at the standards level. For example, if an option is conditional on a future event, does the option create a present obligation now, or only when it has been exercised?

(e) ‘Present’ has two distinct meanings, one being the opposite of absent, and the other being the opposite of future. A term such as ‘existing’ would be clearer.

58. Some respondents asked the IASB to provide more guidance on how to identify a ‘past event’ that is sufficient to give rise to an asset or liability.

Staff analysis

59. In the staff’s view:

(a) it is important to retain the term ‘present’ in the definition of a liability. This emphasises that, to determine whether a liability exists, the key question is whether the entity has an obligation at the reporting date.

(b) for the same reason, and as proposed in the Discussion Paper, the term ‘present’ should be added to the definition of an asset. This notion is already implicit in the existing definition. Making it explicit emphasises the parallel with the definition of a liability.

60. The phrase ‘as a result of past events’ refers to the past transaction or other event that brought the resource under the entity’s control or imposed the obligation on the entity. In the staff’s view, strictly speaking, it is not necessary to identify that event in order to identify whether the entity has an asset or a liability. Nevertheless, for the following reasons, the staff recommends retaining that phrase in both definitions, as proposed in the Discussion Paper:

(a) The staff have not identified any significant problems that arise from the inclusion of that phrase in the existing definitions.

(b) Retaining that phrase emphasises the accounting for the transaction or other event that brought the resource under the entity's control or imposed the obligation on the entity. By identifying that event, an entity can determine how best to portray that event in its financial statements, for example, how best to classify and present income, expenses or cash flows arising from that event.

61. The staff plan to discuss in a future paper what guidance to provide on how to define when a past event has occurred that is sufficient to create an obligation ('obligating event') or an asset.

Question 5 Past event
Does the IASB agree: (a) to retain the term 'present' in the proposed definition of a liability? (b) as proposed in the Discussion Paper, to add the term 'present' to the proposed definition of an asset? (c) retain, in both definitions, the phrase 'as a result of past events'?

Other matters

62. Appendix A summarises some other points raised by respondents. Appendix B considers the latest versions of the definitions being developed by the International Public Sector Accounting Standards Board (IPSASB). The staff do not plan to ask the IASB to discuss these appendices unless IASB members wish to raise them.

Appendix A
Other suggestions received

This table summarises some other points raised by respondents. The staff do not intend to ask the IASB to discuss these issues unless IASB members wish to raise them.

Suggestion received	*Staff reaction*
1. The definitions of financial statement elements, and the resulting recognition, measurement, presentation and disclosure, should be linked through an explicit logic to the objective of general purpose financial reporting.	Paragraph OB4 explains that, to meet the objective, users need information about resources and claims, and changes in resources in claims. The definitions of elements build on that explanation.
2. Assets and liabilities are only representations of the ‘real things out there’ instead of being the real things themselves. For example, a liability is not an obligation as the Discussion Paper suggests but a representation of an obligation.	Assets and liabilities are indeed the ‘real things out there’, they are not the representations of those economic phenomena. The representations of those assets and liabilities in the financial statements are monetary amounts and descriptions.
3. Clarify whether ‘present’ refers to the reporting date or to the date when the financial statements are prepared.	It is unnecessary to clarify this in the general conceptual definition of an asset or liability.
4. The definition of an asset should include the notion of market value because the market determines if a resource is capable of producing future economic benefits.	Although assets will typically have a market value, there is no reason to include that as a definitional feature.

Suggestion received	*Staff reaction*
5. An asset should be defined as an economic good (a product or service that can command a price when sold) that is private (ie characterised by what economists refer to as excludability and rivalrous consumption).	Replacing the notion of a resource with the notion of an economic good would not add clarity. The staff have identified no existing problem that this replacement would solve. The staff will consider in drafting whether to refer to economists' notions of a private resource excludability and rivalrous consumption.
6. The definition of a liability should mirror the definition of an asset more closely by changes such as:	
a. adding a supporting definition of 'present obligation'.	A future paper will discuss feedback on the Discussion Paper's suggestions for supporting guidance.
b. using the concept of control to specify that a liability exists when the transfer of economic resources is out of the entity's control.	A future paper will discuss control, including whether that concept could help in defining an obligation
c. adding 'owed by the entity' to link the obligation to the entity.	The definition refers to an obligation 'of the entity'. This is sufficient to create the link.

Suggestion received	*Staff reaction*
7. Clarify that an obligation can exist at the reporting date even when the obligation does not fall due until some point in the future. For example, consider an invoice on 30 December 2013 for inventory received on the same day, and due for payment 30 days later.	This point is already clear. For example, the same point would apply for any financial liability with a fixed maturity date and no-one doubts that such items are liabilities. Consider in drafting whether to include this point.
8. The entity must be required to transfer this resource to a third party or parties separate from the entity itself.	Consider in drafting whether to include
9. The resource transfer that is required must settle or fulfil the entity's obligation.	Unnecessary detail
10. The definition of a liability should only require an obligation to transfer economic resources – it should not require the ability to perform.	Consider in drafting whether to include
11. Clarify whether a pension liability or asset, recognised net, meets the definition of a liability or asset.	Unnecessary detail

Suggestion received	*Staff reaction*
12. The definition of a liability should focus on the transfer of control, not on transfer of the economic resource itself. Otherwise, a shipping agent would have a liability to deliver the economic resource, not just to provide the shipping service.	The guidance on principal and agent should deal with this point.[3] The shipping agent holds customer's goods as agent. Hence, the agent has no obligation to transfer an economic resource of the agent.
13. It is vital to distinguish a present obligation from future obligations or commitments. For example, a guarantee creates an obligation and a possible deliverable, but a present obligation is triggered only when the original debtor fails to pay.	As explained in the Discussion Paper[4], the issuer has a stand ready obligation even before the original debtor fails to pay.
14. Contra-assets and contra-liabilities should be added as separate elements of financial statements. These reduce the carrying amount of recognised assets or liabilities (for example, accumulated depreciation, asset impairment accounts) and are often determined using a different unit of account, such as a portfolio.	Such items are part of the measurement of the underlying assets and liabilities, they are not separate elements.

[3] Paragraphs 3.31-3.32 of the Discussion Paper

[4] Paragraphs 3.70-3.71 of the Discussion Paper

Appendix B
Public sector

Background

1. Table 2 compares the definitions proposed in this paper with the latest versions of the definitions being developed by the International Public Sector Accounting Standards Board (IPSASB). The staff understands that IPSASB regards its definitions as final, subject to drafting, and expects to include them in its final conceptual framework by the end of this year.

Table 2 definition of an asset and a liability

	IPSASB latest draft	*Recommendation in this paper*
Asset	a resource that an entity presently controls as a result of a past event	a present economic resource controlled by the entity as a result of past events
Liability	a present obligation of an entity for an outflow of resources that results from a past event	a present obligation of the entity to transfer an economic resource as a result of past events
Economic resource	-	a right~~, or other source of value,~~ that is capable of producing economic benefits

Strikethrough shows the one change recommended in this paper.

Staff analysis

2. There are three main differences between the two sets of definitions:

   (a) The IPSASB definition of an asset specifies that the resource is *presently controlled* (as a result of past events). In contrast, the definition in the IASB Discussion Paper specifies that the asset is a *present resource* (and is controlled as a result of past events). In the staff's view, the two definitions have the same effect: they both require that (i) the asset exists at present and (ii) it is controlled at present. The staff believe that the definition in the IASB Discussion Paper shows more clearly the parallel between assets and liabilities because the terms ‘present’ and ‘as a result of past events’ appear in the same positions in both definitions.

(b) The IPSASB definition of an asset refers to a resource (as does the existing IASB definition). The definition in the IASB Discussion Paper uses instead the term ‘economic resource’, supported by a new definition referring to a right (or other source of value). See paragraphs 18-40 for discussion of these issues. The staff recommend no change here.

(c) The IPSASB definition of a liability refers to an ‘obligation … *for an outflow* of resources’. The definition in the IASB Discussion Paper refers instead to ‘an obligation … *to transfer* an economic resource’. The staff believe the IASB definition is marginally clearer, and recommend no change.