For December 2015 ASAF Meeting

ASAF Agenda paper 3A

Recognition Criteria in the *Conceptual Framework*

Accounting Standards Board of Japan

7 December 2015

Introduction

- In this session, ASBJ will introduce its analysis and proposal regarding the recognition criteria in the *Conceptual Framework*
- ASBJ hopes that its analysis and proposal will stimulate the debate about IASB's work to improve the *Conceptual Framework*

I. Background

IASB's existing Conceptual Framework

An item that meets the definition of an element should be recognised if:

(a) It is **probable** that any future economic benefit associated with the item will flow to or from the entity; and

(b) The item has a cost or value that can be measured with reliability.

* Hereinafter, (a) is referred to as the '**probability criterion**'

IASB's ED

- Consideration of 'probability' is referred to as part of the discussion of 'relevance' to a limited extent

Discussion at the previous ASAF meetings

- In July 2015 ASAF meeting, ASBJ suggested that the probability criterion should be retained in the *Conceptual Framework*
- A concern was expressed over the possibility of frequent departure from the *Conceptual Framework*

II. Discussions in the Paper

- **Role of the probability criterion in the *Conceptual Framework***
- **When the probability criterion would be necessary**
- **ASBJ’s proposal that IASB may consider in revising the *Conceptual Framework***

III. Role of the probability criterion in the *Conceptual Framework*

Need for an effective recognition filter

- Definitions of elements together with recognition criteria essentially works as a 'filter' to decide which rights or obligations should be recognised in the financial statements
- Proposed definitions of an asset or a liability does not provide a robust filter

Other reasons

- Risks of inconsistent decisions
- Impact on the usefulness of financial statements
- Challenges for rationalising inconsistencies

IV. When the probability criterion would be necessary? (1/4)

Introduction

- The probability criterion is not necessary in all the Standards
- Focus on the discussion of recognising ‘an asset’ or ‘a liability’
- Executory contracts

ASBJ’s proposal

- For recognition of an asset or a liability created from a right or an obligation that arises from transactions, the probability criterion is unnecessary.
- For recognition of an asset or a liability (that is, an item) or a group of assets and/or liabilities (that is, a group of items) created from a right or an obligation (or rights and/or obligations) that arises from ‘other events’, the probability criterion is necessary.

IV. When the probability criterion would be necessary? (2/4)

‘Transaction’ versus ‘other events’

- Events…Happenings of consequence to an entity
- Transactions…Transfers of something of value between two or more parties
- Other events…Events other than transactions

<table>
<tr><td colspan="2">Events</td></tr>
<tr><td>Transactions</td><td>Other events</td></tr>
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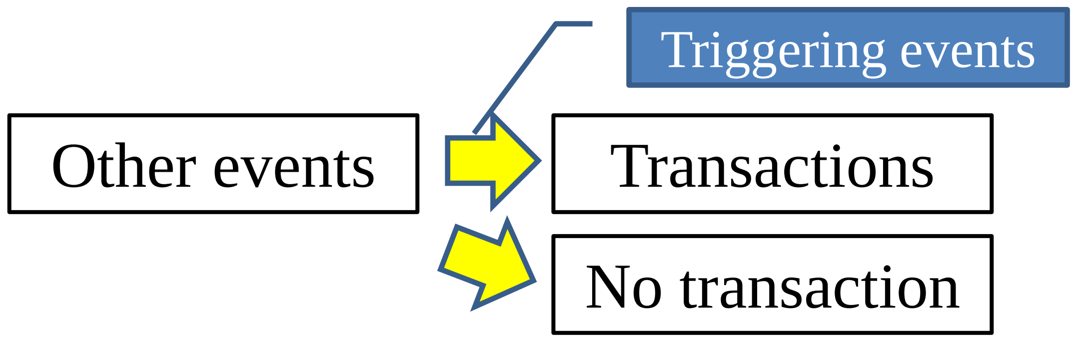
Reflecting the effects of the uncertainty

- Transactions: Effect of the uncertainty is reflected at measurement → **The probability criteria is unnecessary**
- Other events: Effect of the uncertainty should reflected at recognition → **The probability criteria is necessary**

IV. When the probability criterion would be necessary? (3/4)

A right or an obligation resulting from other events

- Future cash flows resulting from the right or the obligation arising from other events is often dependent on the occurrence of events outside the control of the entity
- Interaction between ‘other events’ and ‘transactions’



- The entity usually has no practicable ability to transfer the right or the obligation to third parties

IV. When the probability criterion would be necessary? (4/4)

Consequences of not specifying the probability criterion in the Standards

- Financial information would become less relevant, as a result of
  - Future reversal of previously recognised incomes or expenses
  - Items with significantly different degree of possibility of occurrence being added altogether in the financial statements

Consideration of a group of items

- Even if the probability criterion is not met for an individual asset or a liability (an item), there may be cases where it should be judged at the level of 'a group of assets and/or liabilities'
- The judgment should apply when an entity has a large number of items with similar characteristics such that items as a group are likely to contribute to future net cash inflows to an entity

V. Other Consideration

Application of asymmetrical prudence

- Depending on the situations, asymmetrical prudence may be applicable to recognition and measurement

When measurement uncertainty is extremely high

- When the probability criterion is met, an asset or a liability (or a group of assets and/or liabilities) can be usually measured reliably
- In *extremely rare circumstances*, it might be possible to conclude that it (or they) should not be recognised due to unavailability of reliable information

Questions to Meeting Participants

Q1 Do you agree with the ASBJ's view that the probability criterion should be stipulated more robustly in the *Conceptual Framework*?

Q2 Do you agree with ASBJ's proposal (see page 5 of the slide)? If not why? Do you have any other approach to suggest?

Q3 Do you have any other comments on ASBJ's paper?

Thank you!