

## STAFF PAPER

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## Accounting Standards Advisory Forum

<b>Project</b>	<b>Conceptual Framework</b>
Paper topic	Liability definition and supporting concepts—tentative decisions
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**Purpose of paper**

1. This paper summarises the tentative decisions on the *Conceptual Framework* taken by the Board at its November 2016 meeting.
2. These decisions were reported in the IASB daily staff *Update* for 15 November 2016. The relevant extract is reproduced below.
3. The questions relating to these decisions are set out in Agenda Paper 1—*Overview of session and questions for the ASAF*.

## Extract from IASB daily staff *Update*—15 November 2016

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### *Conceptual Framework for Financial Reporting (Conceptual Framework)* (Agenda Paper 10)

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#### ***Agenda Paper 10C: Liability definition and supporting concepts—the ‘no practical ability to avoid’ criterion***

The Board tentatively decided that, as proposed in the Exposure Draft, the concepts supporting the liability definition should specify that the entity must have ‘no practical ability to avoid’ transferring an economic resource. Ten of 11 Board members agreed and one member disagreed with this decision.

Additionally, the Board tentatively decided:

- a. to refine the concepts on the meaning of ‘no practical ability to avoid’ proposed in paragraph 4.32 of the Exposure Draft. The refined concepts should state that, to conclude that an entity has ‘no practical ability to avoid’ a transfer:
  - i. the factors considered would depend on the type of transaction under consideration. For example, for some types of transaction, an entity may have no practical ability to avoid a transfer if all avoiding actions would have economic consequences significantly more adverse than the transfer itself.
  - ii. it would never be sufficient that the management of the entity intends to make the transfer or that the transfer is probable.

Ten of 11 Board members agreed and one member disagreed with this decision.

- b. to add no further concepts on the meaning of ‘no practical ability to avoid’ to the *Conceptual Framework* beyond those proposed in the Exposure Draft. Although more detailed requirements and guidance might be needed to apply the ‘no practical ability to avoid’ criterion, the requirements and guidance would depend on the type of transaction under consideration and so would be more appropriately developed if and when the Board is developing an IFRS Standard for that type of transaction. All 11 Board members agreed with this decision.

***Agenda Paper 10D: Liability definition and supporting concepts—reducing the risk of further changes***

The Board considered refinements to the Exposure Draft proposals to reduce the risk of adding to the *Conceptual Framework* new concepts that the Board may need to change as a result of decisions it makes in its project on Financial Instruments with Characteristics of Equity. It tentatively decided not to add to the revised *Conceptual Framework*:

- a. two statements in the Exposure Draft that would apply in practice only to questions of how to distinguish liabilities from equity claims:
  - i. a statement in paragraph 4.33(b) of the Exposure Draft that, if an entity prepares financial statements on a going concern basis, that entity does not have a liability for a transfer that would be required only on liquidation.
  - ii. a statement in paragraph 4.30 of the Exposure Draft that an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource (paragraph 4.30). That statement implies that an obligation of an entity to transfer its own equity instruments never constitutes a liability (even if the obligation requires the transfer of a variable number of equity instruments with a fixed total value), which is inconsistent with existing IFRS requirements.
- b. the description of a present obligation proposed in paragraph 4.31 of the Exposure Draft. The two criteria identified in that description—the ‘no practical ability to avoid’ criterion and the ‘as a result of past events’ criterion—would continue to be identified as necessary characteristics of a liability (as discussed in paragraphs 4.32-4.39 of the Exposure Draft). But, by not including that description, the revised *Conceptual Framework* would avoid implying that any claim with these two characteristics is necessarily a liability, as opposed to an equity claim.

All 11 Board members agreed with these decisions.

***Agenda Paper 10E: Liability definition and supporting concepts—other topics***

*Concepts explaining the meaning of ‘as a result of past events’*

The Board tentatively decided that, to clarify the meaning of the phrase ‘as a result of past events’ in the definition of a liability, the revised *Conceptual Framework* should:

- a. refer to an activity of the entity ‘that will or may oblige it to transfer an economic resource that it would not otherwise have had to transfer’, instead of the activity ‘that establishes the extent’ of the entity’s obligation (as was proposed in the Exposure Draft).

- b. include clarification that the enactment of a law (or the introduction of some other enforcement mechanism, policy or practice, or the making of a statement) is not in itself sufficient to give an entity a present obligation. The entity must have conducted an activity to which a present law (or other present enforcement mechanism, policy, practice or statement) applies.

Nine of 11 Board members agreed and two disagreed with this decision.

#### *Other topics*

The Board tentatively decided that, as was proposed in the Exposure Draft:

- a. the definitions of an asset and a liability should include both the term 'present' and the phrase 'as a result of past events'. Ten of 11 Board members agreed with this decision. One Board member was absent.
- b. the concepts supporting the liability definition should not require a 'present claim' against the entity by another party. All 11 Board members agreed with this decision.
- c. the revised *Conceptual Framework* should include the concepts proposed in paragraphs 4.25 and 4.26 of the Exposure Draft on the correspondence between assets and liabilities. All 11 Board members agreed with this decision.
- d. the revised *Conceptual Framework* should not contain concepts that specifically address non-reciprocal transactions. All 11 Board members agreed with this decision.

#### *Drafting of concepts on existence uncertainty*

The staff also highlighted the discussion of existence uncertainty in the Exposure Draft. The staff explained that they planned to split this discussion between two chapters in the revised *Conceptual Framework*:

- a. the discussion of the consequences of existence uncertainty for recognition would remain in the chapter discussing recognition (Chapter 5); but
- b. the discussion of how existence uncertainty arises would be moved to the chapter on identifying assets and liabilities (Chapter 4).