STAFF PAPER

IASB Meeting

Project	**Conceptual Framework**
Paper topic	Liability definition and supporting concepts—other topics

CONTACTS Joan Brown jbrown@ifrs.org

Accounting Standards Advisory Forum, December 2016, Agenda paper 1E
This paper was discussed at the Board meeting in November 2016.

Overview of paper

1. Paragraphs 4.24–4.39 of the Exposure Draft *Conceptual Framework for Financial Reporting* (the Exposure Draft) proposed a new definition of a liability and new concepts to support that definition.

2. Agenda Paper 10C *Liability definition and supporting concepts—the 'no practical ability to avoid' criterion* and Agenda Paper 10D *Liability definition and supporting concepts—reducing the risk of further changes* discuss feedback on two aspects of the proposed concepts. This paper considers feedback on six other aspects.

3. The feedback is discussed by topic:

		Paragraphs
Topic 1	Concepts interpreting 'as a result of past events'	10–35
Topic 2	Need for both 'present' and 'as a result of past events'	36–44
Topic 3	Introducing the concept of a 'present claim'	45–54
Topic 4	Correspondence between assets and liabilities	55–63
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Topic 6	Concepts on existence uncertainty	69–75

Summary of staff recommendations

Concepts interpreting ‘as a result of past events’

4. The staff recommend that, to clarify the meaning of ‘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) add 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.

Need for both ‘present’ and ‘as a result of past events’

5. The staff recommend that the definitions of an asset and a liability should include both the term ‘present’ and the phrase ‘as a result of past events’, as was proposed in the Exposure Draft.

Introducing the concept of a ‘present claim’

6. The staff recommend that the concepts proposed to support the liability definition should not be amended to specify that there must be a ‘present claim’ against the entity by another party.

Correspondence between assets and liabilities

7. The staff recommend that the Board make no changes to the concepts proposed in the Exposure Draft on the correspondence between assets and liabilities.

Concepts for non-reciprocal transactions

8. The staff recommend that, consistently with the proposals in the Exposure Draft, the revised *Conceptual Framework* should not contain concepts that specifically address non-reciprocal transactions.

Concepts on existence uncertainty

9. The staff recommend that the discussion of existence uncertainty proposed in the Exposure Draft should be split in the revised *Conceptual Framework*:
   (a) the discussion of how existence uncertainty *arises* should be moved to the proposed concepts on identifying assets and liabilities (Chapter 4);
   (b) the discussion of the *consequences* of existence uncertainty for recognition should remain in the proposed concepts on recognition (Chapter 5).

Topic 1—Concepts interpreting 'as a result of past events'

Exposure Draft proposals

10. The Exposure Draft proposed to define a liability as 'a present obligation to transfer an economic resource *as a result of past events*'. (Emphasis added)

11. Paragraph 4.36 proposed concepts to interpret the term 'as a result of past events'. It proposed that an entity has a present obligation as a result of past events '*only if it has already received the economic benefits, or conducted the activities, that establish the extent of its obligation'*. (Emphasis added)

Feedback

World Standard-setters meeting

12. As explained in paragraphs 18–21 of Agenda Paper 10B *Liability definition and supporting concepts—background information*, the staff performed an exercise to test the proposed asset and liability definitions and supporting concepts. This exercise included discussions at the World Standard-setters meeting in September 2016 on how the proposed definitions and supporting concepts would apply to a range of illustrative examples. The Examples are reproduced in Agenda Paper 10F *Testing the proposed asset and liability definitions—illustrative examples*.

13. It emerged during these discussions that some participants do not think that the notion that 'the entity has already received the economic benefits, or conducted the activities, that establish the extent of its obligation' is an intuitive interpretation of 'as a result of past events':

    (a) one participant discussing Example 2.5(a)—*Levy triggered when entity generates revenue in two periods* suggested that a liability would be identified in that example, but only because, in that participant's view, the proposed concepts do not interpret the term past event in a 'natural' way.

(b) participants discussing Example 2.7—*Legal requirement to fit smoke filters* concluded there was a liability in that example, because legislation that would apply to the entity's future operations had already been enacted. We think the participants might not have reached this conclusion if the description of 'arisen from past events' proposed in the Exposure Draft had communicated the intended meaning sufficiently clearly.

(c) participants discussing Example 2.9(a)—*Deferred tax—income recognised before it is taxable* suggested that the reference to 'establishing the extent' of the obligation seems to confuse the liability definition with measurement. This suggestion reflects similar views sometimes expressed by stakeholders during outreach meetings.[1]

Responses to Exposure Draft

14. Some respondents to the Exposure Draft also expressed a view that difficulties would arise in applying a concept that 'the entity has received the economic benefits, or conducted the activities, that establish the extent of the obligation'.

15. In particular, a few standard-setters and a few accounting firms noted that the proposals do not provide a definitive answer for all transactions because there may be more than one event that could be regarded as the event that satisfies the description of a 'past event'. Some stated, for example, that it is unclear whether obligations to make variable payments for the purchase of a tangible or an intangible asset (or for a right of use, or for a business) arise when the entity receives the asset (or the right of use, or the business), or at a later date when the entity receives the benefits on which the variable payments are measured. Other respondents noted that several activities might contribute to establishing the extent of some obligations to pay levies. Some respondents suggested that the *Conceptual Framework* needs to give a clear answer for such transactions to ensure consistency in future IFRS Standards.

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1 Board meeting, October 2016, Agenda Paper 10B *Testing the proposed asset and liability definitions—matters arising*, paragraphs 16-18.

Staff analysis

16. The feedback raises four questions:

    (a) do we need concepts to interpret 'as a result of past events'?

    (b) what concept was the Exposure Draft trying to convey?

    (c) is there a better way expressing the concept proposed in the Exposure Draft?

    (d) does it matter that the proposed concept will not give a definitive answer in all cases?

Do we need concepts to interpret 'as a result of past events'?

17. Paragraphs 17-21 of Agenda Paper 10C discuss why the staff think that the *Conceptual Framework* should contain concepts to address transfers that could be avoided through the entity's future actions. Such concepts would be particularly useful for transactions in which a series of events must occur before an entity has an unconditional obligation to transfer an economic resource.

18. The concept proposed in the Exposure Draft (the concept of 'no practical ability to avoid') raises a further question. Applying that concept, it is possible for an entity to have a liability before *all* the events in the series have occurred: an entity could have a liability if it has no practical ability to avoid the events that have *not* yet occurred. So a question arises as to which of the events in the series must have occurred for an entity to have a liability 'as a result of past events'. Should it be the first event (which could, for example, be the passing of new legislation)? Or must it be a particular type of event?

19. For some transactions, the question seems easy to answer. In a transaction involving a straightforward exchange of economic resources (eg purchase of inventory), the event that gives rise to an obligation to transfer an economic resource (eg to pay cash) is the receipt of an economic resource (eg inventory). Even if the entity had entered into an enforceable contract before then, that event (the inception of the contract) would have

given rise only to an obligation to exchange resources. See Example 3.1 *Executory purchase contract* in Agenda Paper 10F.

20. Some exchange transactions have caused more debate. For example, when the Board has been developing requirements for employee benefits that are subject to vesting conditions, it has debated whether an entity's liability to pay such benefits arises:

    (a) when the entity receives the services from the employee that give the employee a conditional right to benefits, or

    (b) when the vesting conditions are met.

    Although such transactions have caused debate, the Board has consistently concluded that the obligation arises when the entity receives the employee services. And this conclusion is generally regarded as ensuring a faithful representation of the transaction as a whole—it ensures that the entity recognises the cost of the employee services and an obligation to pay for them—when the entity receives the benefit of those services.

21. The greatest difficulties arise for transactions that do not involve a direct exchange of economic resources, typically transactions with governments involving levies, taxes or grants. There may be several events that must occur before the entity is required to pay a tax or levy. And, if no economic resource is received in exchange, it is less clear which event creates a liability.

22. The difficulties were illustrated during the development of IFRIC 6 *Liabilities arising from Participating in a Specific Market—Waste Electrical and Electronic Equipment* and IFRIC 21 *Levies*. Both interpretations were needed because of difficulties in identifying the 'past event' that gave rise to a present obligation. The interpretations have not fully resolved the difficulties. IFRIC 21 has been criticised by a range of stakeholders, including users, preparers and auditors of financial statements and national standard-setters.

23. The staff think that concepts to help identify the 'event' to consider in applying the 'as a result of past events criterion' would be useful for developing and interpreting IFRS Standards.

What concept was the Exposure Draft trying to convey?

24. The interpretation of 'as a result of past events' proposed in the Exposure Draft aimed to encapsulate a concept that:

    (a) the entity must have done something (received economic benefits or conducted an activity); and

    (b) as a consequence of having done that thing the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. The activity increases the economic resource that the entity will or may have to transfer—it establishes the extent of the entity's obligation.

25. The activity conducted by the entity could be operating in a particular market, or even simply existing, on a particular date.

26. An implication of this concept is that the enactment of a law is not in itself sufficient to give an entity a present obligation. It is necessary that the entity has conducted some activity to which that law applies.

27. The transactions within the scope of IFRIC 6 provide an example to illustrate these points:

Example: Costs within scope of IFRIC 6

Fact pattern

IFRIC 6 applies to one type of obligation arising from a European Union directive on waste electrical and electronic equipment. Among other things, the directive specifies how EU member states should fund the costs of disposing of 'historical' household waste, ie household equipment that was manufactured and sold before the directive came into force in August 2005.

The directive states that each member state should require the costs to be borne by producers of that type of equipment that are in the market during a period specified by the member state (the measurement period). Producers should contribute proportionately, eg in proportion to their respective share of the market. Member states are free to select a measurement period. In an example discussed in the Basis for Conclusions accompanying IFRIC 6, the measurement period is the 2007 calendar year.

The question considered in IFRIC 6

The IFRS Interpretations Committee was asked to identify the event that creates a present obligation for a producer.

How the Exposure Draft concepts would apply

In this example, there are three events to consider:

(a) manufacture and sale of equipment before August 2005;

(c) participation in the market in 2007; and

(d) implementation of the EU directive.

Applying the concepts proposed in the Exposure Draft, the manufacture or sale of equipment before August 2005 is not a relevant 'past event'. Even though the costs relate to disposing of equipment manufactured and sold before August 2005, the amount any producer is obliged to contribute to the costs is independent of whether that producer manufactured and sold equipment before that date.

Applying the concepts proposed in the Exposure Draft, the relevant 'past event' would be participation in the market in the specified measurement period (eg 2007). As a result of conducting this activity, a producer is obliged to transfer an economic resource (contribute to historical waste disposal costs) that it would not otherwise have had to transfer.

The implementation of the EU directive is not the relevant 'past event': only when a producer does something to which a law applies does it have a present obligation.

Comparison with the consensus in IFRIC 6

The consensus in IFRIC 6 is the same as the conclusion reached applying the proposed concepts—a producer has an obligation 'as a result of past events' only when it participates in the market in the measurement period.

However, the IFRS Interpretations Committee relied on different concepts to support its consensus. It reasoned that participation in the market in the measurement period created a present obligation because it 'triggered the obligation' and, until then, any obligation was dependent on the entity's future actions.[2]

[2] IFRIC 6, BC4 and BC7–BC10

> For the particular obligation within the scope of IFRIC 6, participation in the market during the measurement period is *both* the event that creates an obligation for the entity to transfer an economic resource that it would not otherwise have had to transfer (establishes the extent of the entity's obligation) *and* the final event required to trigger a requirement to contribute to waste disposal costs. For that reason, the proposed concepts and the Interpretation Committee's rationale lead to the same outcome. However, for some other levies (including some of those illustrated in the examples accompanying IFRIC 21), the two events may occur at different times. So, the proposed concepts can lead to outcomes different from those in IFRIC 21. See Examples 2.5(a)–(c) *Levies* in Agenda Paper 10F.

Is there a better way expressing the concept proposed in the Exposure Draft?

28. The Exposure Draft tried to convey the meaning of 'as a result of past events' with the statement that the entity must have 'received the benefits, or conducted the activities that establish the extent of its obligation'.

29. The aim of that description was to encapsulate the concept in paragraph 24. However, the feedback suggests that the description—particularly the phrase 'establish the extent'—does not clearly convey the intended concept, and could be read to imply an obligation must be measurable. The staff think that the intention of the concept could be clearer if, instead of referring to an event that 'establishes the extent' of an entity's obligation, the revised *Conceptual Framework* refers to an event that will or may oblige the entity to transfer an economic resource that it would not otherwise have had to transfer.

30. Given the conclusions reached by world standard-setters discussing Example 2.7—*Legal requirement to fit smoke filters* (see paragraph 13(b)), the staff think it could also be helpful to clarify that the enactment of a law is not in itself sufficient to give an entity a present obligation.

31. These changes could be effected by amending paragraph 4.36 of the Exposure Draft along the following lines:

> 4.36 An entity has a present obligation as a result of ~~a~~ past events only if it has already received ~~the~~ economic benefits, or conducted ~~the~~ activities, that will or may oblige it to transfer an economic resource that it would not otherwise have had to transfer ~~establish the extent of its obligation~~. The economic benefits received could include, for example, goods or services. The activities conducted could include, for example, operating in a particular market or simply even existing. If the economic benefits are received, or the activities are conducted, over time, a present obligation will accumulate over time (if, throughout that time, the entity has no practical ability to avoid the transfer).
>
> 4.36A The enactment of a law (or the introduction of some other enforcement mechanism, policy or practice, or the making of 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.

Does it matter that the proposed concept will not give a definitive answer in all cases?

32. A few standard-setters and a few accounting firms noted that the proposed description of a present obligation does not provide a definitive answer for all transactions because there may be more than one event that satisfies the description of a past event, ie more than one receipt of economic benefits or activity that establishes the extent of the entity's obligation (see paragraph 15).

33. However, the *Conceptual Framework* does not aim to give a single clear answer to every financial reporting question. (If it did, there would be no need for IFRS Standards and Interpretations.) Sometimes, as illustrated in Example 2.5(c)—*Threshold levy* in Agenda Paper 10F, the proposed description of a 'past event' does not give a single clear answer but may nevertheless help in applying the liability definition by narrowing the range of possibilities.

34. The staff think that amending the proposed description along the lines suggested in paragraph 31 could more effectively narrow the range of possibilities. It may be easier to determine whether a particular activity will or may oblige an entity to transfer an economic resource that it would not otherwise have had to transfer, than to

determine whether that activity ‘establishes the extent of the entity’s obligation’. For example, in Example 2.5(b)—*Levy triggered if entity operates at end of reporting period* in Agenda Paper 10F, there are several factors that establish the extent of the levy that will be charged at the end of the bank’s reporting period. However, it is clear that at its interim reporting date, the bank has already conducted activities that may oblige it to pay a levy that it would not otherwise have had to pay—the activities conducted in the six month period leading up to the interim reporting date will increase any levy charged at the end of its reporting period.

Staff recommendations

35. The staff recommend that, to clarify the meaning of ‘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) add 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.

Question 1—Concepts interpreting ‘as a result of past events’
Do you agree with the staff recommendation in paragraph 35?

Topic 2—Need for both 'present' and 'as a result of past events'

Exposure Draft proposals

36. Like the Discussion Paper that preceded it, the Exposure Draft proposed that:

    (a) the phrase 'as a result of past events' should remain in the definitions of an asset and a liability; and

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

	Existing definition	Proposed definition[3]
Asset (of an entity)	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 (of an entity)	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**.

37. Some respondents to the Discussion Paper disagreed with including both 'present' and 'as a result of past events' in the definitions. They argued that one of the terms is redundant because a present economic resource or present obligation cannot exist without a past event.

38. The Board discussed this feedback when it was developing the Exposure Draft. It decided not to make any changes to its proposals, on the grounds that:

3 Exposure Draft, paragraph 4.4.

(a) the phrase 'as a result of past events' is important to the proposed definition of a liability;

(b) neither the Board nor stakeholders had identified any significant problems arising from including both 'present' and 'as a result of past events' in the existing liability definition; and

(c) adding 'present' to the asset definition emphasises the parallels between the asset and liability definitions.

Feedback from respondents

39. Some respondents to the Exposure Draft suggested omitting either 'present' or 'as a result of past events' from the definitions of an asset and a liability on the grounds that it is unnecessary to have both—a 'present' obligation (or economic resource) is one that is the result of past events.

40. Some of those respondents—including standard-setters, accounting firms and preparers of financial statements—suggested omitting the phrase 'as a result of past events'. Those who give reasons argued that:

(a) the focus should be on the existing rights and not how they arose; or

(b) an entity cannot have present control without a past event; or

(c) 'as a result of past events' is included within the description of a present obligation.

41. Some respondents—including accounting firms, accountancy bodies, standard-setters, and preparers—instead suggested omitting the term 'present'. Those who gave reasons argued that this term:

(a) is unnecessary because a resource controlled by the entity could not be anything other than present; or

(b) is confusing because it implies that the right or obligation must be unconditional or immediate, so that, for example, a purchased option would not qualify as an asset until it can be exercised.

Staff analysis

42. It can be argued that there is some redundancy in the definitions, especially if ‘present’ is defined to mean ‘as a result of past events’. However, changing the proposed definitions at this stage would be justified only if a significant problem has been identified with those definitions.

43. Although the term ‘present’ could in isolation imply that a right or obligation must be unconditional, we think that the concepts supporting the asset and liability definitions make it clear that this is not how the term should be interpreted. In addition, the staff think it is clear from the supporting guidance that purchasing or writing an option creates a present economic resource (a right) or a present obligation immediately, even if the option is not yet exercisable.

Staff recommendation

44. The staff recommend that the definitions of an asset and a liability should include both the term ‘present’ and the phrase ‘as a result of past events’, as was proposed in the Exposure Draft.

Question 2—Need for both ‘present’ and ‘as a result of past events’
Do you agree with the staff recommendation in paragraph 44?

Topic 3—Introducing the concept of a 'present claim'

Exposure Draft proposals

45. The existing *Conceptual Framework* discusses the objective of general purpose financial reporting. It states that:

> General purpose financial reports provide information about the financial position of a reporting entity, which is information about the entity's economic resources and the *claims against the reporting entity*.[4] (Emphasis added)

46. The Exposure Draft proposed to carry forward this statement. Chapter 4 of the Exposure Draft also introduced the elements of financial statements by identifying liabilities and equity as the two types of claims against the entity. However, the proposed definition of a liability and supporting concepts make no further reference to liabilities being claims against the entity.

Feedback received

Feedback from respondents to Exposure Draft

47. Some respondents from Australia and New Zealand (including the two standard-setters, a preparer of financial statements and an accountancy body), stated that liabilities must be present claims against the entity's assets, ie that there must be another party or parties (which could be the public at large) that is or are entitled to receive, or benefit from, the future transfer of economic resources, and that would therefore suffer harm if the entity failed to meet its obligations. Those respondents expressed a view that, by focusing on the entity's practical ability to avoid a future transfer, the proposed description of a present obligation might be interpreted to encompass items that are not present claims—items such as future asset maintenance costs, future salaries and future operating losses. The standard-setters suggested that:

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[4] Paragraph OB12.

(a) the proposed criteria should be replaced by a discussion of the characteristics of a present obligation; and

(b) the discussion should focus more on determining whether another party has a present claim against the entity's assets, rather than on whether a future transfer of resources can be avoided.

Advice from the Accounting Standards Advisory Forum (ASAF)

48. The staff discussed this suggestion with the ASAF in July 2016.

49. Two ASAF members thought that the concepts supporting the liability definition should specify the need for a present claim against the entity by another party. One of those ASAF members— representing the Australia and New Zealand standard-setters—suggested that not only would such an addition help clarify why entities have no liability for future maintenance costs, it would also help the Board reach decisions on variable and contingent payments for the purchase of assets—it might not be clear that the purchaser has a present obligation for payments that are conditional on future earnings, but it would be clear that the seller has a claim against the entity.

50. However, other ASAF members expressed concerns about specifying the need for a present claim against the entity by another party.

(a) Several members stated that 'claim' is a legal term. Consequently, requiring another party to have a 'present claim' could imply that liabilities do not arise until another party is in a position to enforce a claim against the entity. For example, customers might be regarded as having a 'present claim' for warranty repairs only when a fault has arisen.

(b) One member questioned whether there is a problem that needs to be solved. That member thought that the Exposure Draft was already clear that an entity cannot have a liability for future costs, because the obligation has to have arisen from past events.

(c) One member suggested that, because the counterparty is defined so broadly, specifying a need for a present claim would not add much clarity and could lead to more confusion.

(d) One member suggested describing a liability as a present claim by another party may lead to symmetrical accounting requirements for assets and liabilities. This addition would not be a minor change and the Board should ensure it would not lead to unintended consequences.

Staff analysis

51. The concepts supporting the liability definition would not be changed by specifying the need for a present claim against the entity by another party because:

(a) as explained in paragraphs 45–46, the *Conceptual Framework* already identifies liabilities as claims.

(b) we think that there are no inconsistencies (or even differences in emphasis) between the notion of a present claim against the entity by another party and the concepts proposed in the Exposure Draft. The primary purpose of some of the proposed concepts—such as the 'past events' and 'no practical ability to avoid' criteria—is to help identify when a present claim arises.

(c) paragraph 4.25 of the Exposure Draft included a statement that if one party has an obligation to transfer an economic resource (a liability), another party has a right to receive that economic resource (an asset). That statement could be rephrased to describe the other party as having a claim against the entity (a particular type of asset).

52. The staff do not think that specifying the need for a 'present claim' would automatically lead to symmetrical accounting requirements for assets and liabilities. Paragraph 4.26 of the Exposure Draft clarified that a requirement for one party to recognise a liability (or asset) and measure it at a specified amount does not imply that the other party must recognise the corresponding asset (or liability) and measure it at

the same amount. That statement would continue to apply if the Board specified that the definition of a liability requires a present claim against the entity by another party.

53. However, the staff accept ASAF members' views that the term 'claim' could be misinterpreted, and that it is not necessary to describe a liability as a present claim. The concepts proposed in the Exposure Draft (and in particular the description of a past event) are sufficient: they would not lead to liabilities being identified for future asset maintenance costs and similar items. (See Example 2.7—*Legal requirement to fit smoke filters* and Example 2.8—*Refurbishment costs* in Agenda Paper 10F.)

Staff recommendation

54. For the reasons set out in paragraph 52, the staff recommend that the concepts proposed to support the liability definition should not be amended to specify that there must be a 'present claim' against the entity by another party.

Question 3—Introducing the concept of a 'present claim'
Do you agree with the staff recommendation in paragraph 54?

Topic 4—Correspondence between assets and liabilities

Exposure Draft proposals

55. The Exposure Draft proposed that:

> 4.25 If one party has an obligation to transfer an economic resource (a liability), it follows that another party (or parties) has a right to receive that economic resource (an asset). The party (or parties) could be a specific person or entity, a group of people or entities, or society at large.
>
> 4.26 A requirement for one party to recognise a liability (or asset) and measure it at a specified amount does not imply that the other party must recognise the corresponding asset (or liability) or measure it at the same amount. Applying different recognition criteria or measurement requirements to the liability (or asset) of one party and the corresponding asset (or liability) of the other party may sometimes be an outcome of the decisions intended to meet the objective of financial reporting.

56. Paragraph BC4.78 of the Basis for Conclusions explained that the Board thought that making the general point set out in paragraph 4.25 would help in applying the definitions. For example, it indicates that the counterparty to a constructive obligation has an asset.

Summary of feedback

57. A few—mainly European—respondents expressed explicit support for including in the *Conceptual Framework* the statement that if one party has a liability another party has an asset.

58. However, some other respondents—again mainly European—suggested that the statement should be omitted from the *Conceptual Framework*:

    (a) a few questioned whether the statement always holds true. They identified decommissioning and other environmental obligations as examples of obligations for which they think no other party might have corresponding assets. A few suggested that, even if the other party had a right to receive the economic resource, it might not control that right. For example, it is arguable whether society at large has the ability to direct, or prevent all other parties from directing, the use of the economic resource that arises from an entity's enforceable obligation to provide public goods.

(b) a few respondents questioned the usefulness of, or need for, a definitive statement about symmetry given that:

  (i) they do not think it sheds any further light on the definition of a liability; and

  (ii) it would often relate to assets that holders would often be unaware they possessed and need not recognise. Respondents suggested that the *Conceptual Framework* should not imply that entities need to look for such assets.

(c) a few respondents expressed a concern that the proposal could have unintended consequences, including illogical changes in requirements. They suggested that, for example, entities might no longer be able to recognise liabilities for legal fees associated with a restructuring until the legal services had been provided, because until then, no lawyer would have a right to payment.

59. A few respondents commented on the statement that 'applying different recognition criteria or measurement requirements to the liability (or asset) of one party and the corresponding asset (or liability) of the other party may sometimes be an outcome of the decisions intended to meet the objective of financial reporting':

(a) a few European respondents supported this statement, suggesting that it was an acknowledgement of the role of prudence and asymmetry in recognition criteria. One suggested that the statement may not go far enough—different recognition criteria are required not just 'sometimes' but 'more often than not'.

(b) a few respondents from South America and Oceania disagreed with the statement on the grounds that they believe it conflicts with the notion of neutrality. One thought that the wording was 'vague and unhelpful' and ought to be explained better, but noted that a clearer statement may run counter to the concept that financial statements should provide information that is neutral.

Staff analysis

60. Regarding the respondents' suggestion that for some liabilities—such as decommissioning or other environmental obligations—there is no party with a corresponding asset (see paragraph 58(a)):

    (a) the Board discussed this view when it was developing the Exposure Draft and decided that for such obligations, society at large has an asset—as it explained in paragraph BC4.80 of the Basis for Conclusions, the people living in the area have a right to receive the services required to restore their environment; and

    (b) no respondents put forward new arguments to challenge the analysis in the Basis for Conclusions.

61. Regarding the suggestion that the proposed concepts could lead to unwelcome changes in accounting, for example by preventing liabilities being identified for fees for future legal services associated with a restructuring (see paragraph 58(c)):

    (a) the reason for including fees for future legal fees in a restructuring provision is not that a liability yet exists to pay those fees. The reason is that other liabilities, which do exist, should be measured at an amount that includes costs necessarily incurred to settle those liabilities. These costs might include some future legal fees.

    (b) nothing in the proposed concepts changes that argument. See Example 2.6(b)—*Restructuring costs—associated legal fees* in Agenda Paper 10F.

62. Regarding the suggestion that the concepts imply a need to look for assets that correspond to another party's liabilities (see paragraph 58(b)(ii)), the staff think that the proposed concepts do not imply this outcome. Paragraph 4.26 explicitly stated that a requirement for one party to recognise a liability (or asset) and measure it at a

specified amount does not imply that the other party must recognise the corresponding asset (or liability) or measure it at the same amount.

Staff recommendation

63. Few respondents challenged the proposed concepts on the correspondence between assets and liabilities. And the staff think that those respondents who did raise concerns did not identify any new issues that need further consideration by the Board. Consequently, the staff recommend that the Board make no changes to the concepts proposed in the Exposure Draft on the correspondence between assets and liabilities.

Question 4—Correspondence between assets and liabilities
Do you agree with the staff recommendation in paragraph 63?

Topic 5—Concepts for non-reciprocal transactions

Exposure Draft proposals

64. The Exposure Draft contained no concepts that specifically addressed assets and liabilities that arise in non-reciprocal (non-exchange) transactions.

Summary of feedback

65. A few respondents—accounting firms and accountancy bodies—suggested that the *Conceptual Framework* should include concepts that specifically address non-reciprocal transactions such as donations, income taxes, value added taxes and other taxes and levies. Those respondents argued that:

    (a) non-reciprocal transactions can be an important feature of a business activity of an entity and the most appropriate concepts for those transactions are not necessarily the same as the concepts developed in the *Conceptual Framework*, which tend to assume commercial exchange transactions.

    (b) IFRIC 21 demonstrates why such transactions need to be considered separately and urgently. IFRIC 21 does not give any guidance on the circumstances in which the cost of a levy should be recognised as an expense or an asset. It refers to the requirements of other IFRS Standards, but there are no other IFRS Standards that specifically address non-exchange payments.

Staff analysis

66. The staff do not agree that the concepts developed in this project have been developed assuming that transactions are commercial exchanges. Indeed some concepts—in particular the concepts supporting the liability definition—have been developed with significant consideration given to non-reciprocal transactions.

67. The staff think that the concepts that have been developed in this project are equally suitable for reciprocal exchange transactions and non-reciprocal transactions. In both cases, the starting point should be to identify the rights and obligations arising from the transaction. In both cases, decisions about recognition, measurement, presentation and disclosure should be taken with the aim of providing information that is relevant and faithfully represents what it purports to represent, at a cost that does not exceed the benefits. And in both cases, decisions about presentation and disclosure should also consider how the information could be communicated in the most efficient and effective manner.

Staff recommendation

68. For the reasons in paragraphs 66–67, the staff recommend that, consistently with the proposals in the Exposure Draft, the revised *Conceptual Framework* should not contain concepts that specifically address non-reciprocal transactions.

Question 5—Concepts for non-reciprocal transactions
Do you agree with the staff recommendation in paragraph 68?

Topic 6—Concepts on existence uncertainty

Exposure Draft proposals

69. The Exposure Draft discussed situations in which it is uncertain whether an asset or liability exists. The Exposure Draft explained how existence uncertainty arises and its consequences for recognition decisions. All of the discussion was in the chapter on recognition:

> 5.15 Some assets, for example, rights to benefit from items such as know-how and customer or supplier relationships, are not contractual or other legal rights. It may therefore be uncertain whether there is an asset or whether it is separable from the business as a whole (that is, it may be unclear whether there is an asset distinct from goodwill). In some such cases, uncertainty about the existence of an asset combined with the difficulty of separately identifying the asset may mean that recognition may not provide relevant information.
>
> 5.16 For some liabilities, it may be unclear whether a past event causing an obligation has occurred. For example, if another party claims that the entity has committed an act of wrongdoing and should compensate the other party for that act, it may be uncertain whether the act occurred or whether the entity committed it. In some such cases, the uncertainty about the existence of an obligation, possibly combined with a low probability of outflows of economic benefits and a high level of measurement uncertainty, may mean that the recognition of a single amount would not provide relevant information.

World Standard-setters meeting feedback

70. Example 2.3—*A court case* in Agenda Paper 10F has a fact pattern of the type addressed by paragraph 5.16 of the Exposure Draft. The facts are that ten people died after a wedding, possibly as a result of food poisoning from products supplied by the entity. Legal proceedings have been started against the entity, but the entity disputes that its products were the cause of the deaths.

71. This example was discussed by participants at the World Standard-setters meeting. The staff expected participants to reach a conclusion that it is uncertain whether a liability exists in this example. We expected them to reach this conclusion because:

(a) applying the concepts proposed in paragraph 5.16 of the Exposure Draft (which no respondents challenged), we think that the activity that would establish an obligation is the supply of contaminated product. The supply of product is a past event, so if the supplied products were contaminated, the entity would have a present obligation. In the example, it is uncertain whether the product was contaminated, so it is uncertain whether the entity has any obligation, ie whether a liability exists.

(b) this conclusion is consistent with existing IFRS requirements. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* identifies disputed court cases as examples of existence uncertainty. IAS 37 states that 'in rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation'. IAS 37 then goes on to specify that a provision should be recognised if 'it is more likely than not that a present obligation exists'.

72. However, the papers for the World Standard-setters meeting did not reproduce paragraph 5.16 of the Exposure Draft. And only a few of the participants in the group discussing this example concluded that the example was a case of existence uncertainty. Others reached different conclusions:

(a) some thought the entity did have a liability, but disagreed about which event gave rise to that liability. The events they suggested included:

(i) the supply of food by the entity—at which point the entity would incur a liability to stand ready to compensate anybody harmed by the food;

(ii) the death of the people eating the food; or

(iii) the start of legal proceedings against the entity.

(b) others thought that the entity did not have a liability, because there had not yet been a court judgement concluding that the entity was at fault.

Staff analysis

73. The difficulties that participants had in reaching a view on whether a liability exists (and if so, what the nature of the liability is) suggest that there is a need for a discussion of existence uncertainty within the concepts supporting the asset and liability definitions. In support of adding such concepts, it can also be noted that:

(a) no fundamentally new concepts would be needed— we could copy or move some the discussion of existence uncertainty (ie how it arises) from the recognition concepts to the definition concepts; and

(b) the concepts supporting the asset and liability definition would then be more complete. The concepts proposed in the Exposure Draft discussed ‘outcome uncertainty’, ie the effect of uncertainty about *future* events. Adding a discussion of existence uncertainty would also clarify the effect of uncertainty about *past* events.

74. The paragraphs below illustrate one way in which the concepts for liabilities could be split between the definitions chapter and the recognition chapter. The concepts for assets could be split in a similar way. However, the exact words would be chosen when the revised *Conceptual Framework* is being drafted.

Definition of a liability

<u>4.39A In some cases, there might be uncertainty about past events. For example, if another party claims that an entity has committed an act of wrongdoing and should compensate the other party for that act, it might be uncertain whether that act occurred, whether the entity committed it or how the law applies. Until the uncertainty about the past events is resolved—for example by a court ruling—it is uncertain whether a liability exists. Paragraph 5.16 discusses recognition of liabilities whose existence is uncertain.</u>

Recognition

5.16 ~~For some liabilities, it may be unclear whether a past event causing an obligation has occurred. For example, if another party claims that the entity has committed an act of wrongdoing and should compensate the other party for that act, it may be uncertain whether the act occurred or whether the entity~~

~~committed it.~~ Paragraph 4.39A discusses cases in which there might be uncertainty about whether a liability exists. In some such cases, the uncertainty about the existence of an obligation, possibly combined with a low probability of outflows of economic benefits and a high level of measurement uncertainty, may mean that the recognition of a single amount would not provide relevant information.

Staff recommendation

75. For the reasons in paragraph 73, the staff recommend that the discussion of existence uncertainty proposed in the Exposure Draft should be split in the revised *Conceptual Framework*:

    (a) the discussion of how existence uncertainty *arises* should be moved to the proposed concepts on identifying assets and liabilities (Chapter 4);

    (b) the discussion of the *consequences* of existence uncertainty for recognition should remain in the proposed concepts on recognition (Chapter 5).

Question 6—Concepts on existence uncertainty
Do you agree with the staff recommendation in paragraph 75?