STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**
Paper topic	Feedback summary—Elements of financial statements—Assets

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Purpose of paper

1. This paper is one of three papers that summarise feedback on Chapter 4 of the Exposure Draft *Conceptual Framework for Financial Reporting* ('the Exposure Draft').

2. Chapter 4 of the Exposure Draft identifies and defines five elements of financial statements. This paper summarises feedback on the definition of an asset and on the concepts supporting that definition.

Agenda paper	Definitions discussed
10D (this paper)	**Asset**
10E	Liability Equity
10F	Income and expenses Undefined elements

3. Some proposals in Chapter 4 relate to both assets and liabilities. Comments on those proposals are discussed in *this* paper.

4. The Exposure Draft asked respondents whether they agreed with the proposed definitions and if they had any comments on the guidance supporting those definitions. This paper provides a high-level summary of the comments received. Where appropriate, we will provide more detail for future meetings.

Summary of key messages

Definitions of an asset and a liability

5. Among the regulators, standard-setters, accountancy bodies, accounting firms, academics and individuals who commented, there was broad support for the proposed changes to the definitions of an asset and a liability. The views of preparers of financial statements were more evenly divided. Few users of financial statements commented.

6. The main concern of those who disagreed with the proposed definitions was the proposal to replace the notion of 'expected' economic benefits with a notion of the 'potential to produce' economic benefits. Some respondents expressed concerns that this change would increase the population of items identified as assets and liabilities. They fear that this, in combination with proposed changes to the recognition criteria, could lead to more low-probability items being recognised in financial statements. In their view, recognising such items could make financial statements less useful.

Unit of account

7. Some respondents said they would like to see more guidance in the *Conceptual Framework* on selecting a unit of account.

Executory contracts

8. Some respondents disagreed with the proposal that executory contracts give rise to a combined right and obligation that constitute a single asset or liability. Those respondents expressed a view that executory contracts give rise to a separate right and separate obligation. They expressed different views on whether, and if so when, the separate right and separate obligation should be treated as a single unit of account.

Structure of paper

9. This paper summarises feedback on:

   (a) the definition of an asset (including feedback on terms that are common to both the definition of an asset and the definition of a liability)—paragraphs 10-23.

   (b) guidance supporting the definition of an asset:

      (i) the rights that constitute an economic resource—paragraphs 24-28;

      (ii) the meaning of control in the definition of an asset—paragraphs 29-34.

   (c) concepts for selecting a unit of account—paragraphs 35-50.

   (d) concepts on executory contracts—paragraphs 51-60.

DEFINITION OF AN ASSET

Exposure Draft proposals (paragraphs 4.4 and BC4.4-BC4.45)

Proposals affecting both the definition of an asset and the definition of a liability

10. The Exposure Draft proposed significant changes that would affect both the definition of an asset and the definition of a liability. In particular, the Exposure Draft proposed to replace the notion of 'expected' economic benefits with a notion of the 'potential to produce' economic benefits; to define an economic resource as a 'right'; and to align the asset and liability definitions more closely with each other:

	Existing definitions	Proposed definitions
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.
Economic resource	Not defined	A right that has the potential to produce economic benefits.

11. The purpose of replacing the notion of 'expected' economic benefits with a notion of the 'potential to produce' economic benefits would be to clarify the definitions. Some people interpret the term 'expected' to mean that an item can be an asset or a liability only if the probability of future inflows or outflows exceeds some minimum threshold. However, such an interpretation was not intended, and has not been applied by the Board in setting recent IFRS Standards.

12. Where rights and obligations have a low probability of future inflows or outflows, identifying those rights and obligations as assets and liabilities would not necessarily result in the assets and liabilities being recognised in the financial statements. As discussed further in Agenda Paper 10G *Feedback summary—Recognition*, a low probability of future inflows or outflows would be one of the factors taken into consideration in decisions about recognition.

13. The definitions proposed in the Exposure Draft are very similar to those developed in the preceding Discussion Paper.[1] The main difference is that the Discussion Paper proposed to define an economic resource as a 'right, <u>or other source of value</u>'. However, the Board decided that the notion of an 'other source of value' was too vague to be useful. The Exposure Draft instead explains that the notion of a 'right' encompasses not only legal rights, but also access that an entity controls in other ways, for example, by having the ability to keep know-how secret.

[1] Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, July 2013.

Summary of feedback

Comments applicable to both the definition of an asset and the definition of a liability

14. The main aspects of the proposed asset and liability definitions are similar: neither definition requires 'expected' inflows or outflows; both definitions refer to a 'present' right or obligation, both link that right or obligation to the entity, and both refer to the right or obligation being 'a result of past events'. Consequently, many of the comments on the asset or liability definitions applied to both of the definitions. And most respondents who broadly agreed (or disagreed) with the proposed asset definition also broadly agreed (or disagreed) with the proposed liability definition.

15. Many respondents commented on the proposed asset and liability definitions. And with the exception of preparers of financial statements, most of those expressing an overall view broadly agreed with the proposed definitions and with the reasons for them. Those broadly agreeing included most of the regulators, standard-setters, accountancy bodies, accounting firms, academics and individuals expressing an overall view. One accounting firm noted an additional reason for removing the requirement for expected inflows or outflows: removing this requirement would eliminate the anomaly that assessments of the existence of some assets and liabilities can depend on whether they are accounted for individually or within larger units of account.

16. The views of preparers of financial statements were more evenly divided between those who broadly agreed and those who broadly disagreed with the proposed definitions. Few users of financial statements commented on the asset and liability definitions and those who did comment were divided in their views.

17. Of the respondents expressing overall disagreement, the main concern of most was the proposal to replace the notion of 'expected' economic benefits with a notion of the 'potential to produce' economic benefits. Respondents expressed concerns that:

    (a) the change would increase the population of items identified as assets and liabilities and, in combination with the proposed changes to the recognition criteria could lead to more low-probability items being recognised in financial statements, making them less useful.

(b) even if many of those assets were not recognised in financial statements, the need to identify the assets and then consider the recognition criteria would add complexity and inefficiency to financial reporting.

(c) the proposed definitions would be inconsistent with the definitions used in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets*.

(d) the changes are unnecessary. The existing definitions are well understood and do not lead to flawed results.

18. Some of the respondents who broadly agreed with the proposal to replace the notion of 'expected' economic benefits with a notion of the 'potential to produce' economic benefits, commented on the interaction between this proposal and the proposed concepts for recognition:

(a) a few respondents simply highlighted the need to consider the definitions in conjunction with the proposed concepts on recognition—with the recognition criteria becoming more important to prevent recognition of some assets and liabilities.

(b) a few respondents suggested that, to avoid misunderstandings, the *Conceptual Framework* should more clearly emphasise in its guidance on the asset and liability definitions that not all items that meet the definitions are necessarily recognised in financial statements. Some specifically suggested adding a cross-reference from paragraph 4.13 to the relevant concepts on recognition (paragraphs 5.17-5.19).

(c) a few respondents said that their support for the definitions depended on the Board withdrawing its proposal to remove the 'probable inflows or outflows' recognition criterion from the *Conceptual Framework.*
Agenda Paper 10G *Feedback summary—Recognition* contains further discussion of the comments on that proposal.

19. Regarding the practical implications of the proposed changes to the asset and liability definitions:

(a) some (predominantly European) respondents suggested that the Board should conduct further work to test the definitions. Suggestions included:

(i) field tests of the proposed definitions and related guidance to ensure that they are understandable and can be put into effect without undue effort; and

(ii) a fuller analysis of the practical implications of the proposed definitions. Respondents suggested that the Board should do more by way of effects analysis than simply identify inconsistencies between the proposed concepts and existing IFRS Standards. A few respondents said that in the absence of a more detailed analysis, they had been unable to form an overall view on the impact of the changes to the definitions and recognition criteria, or to support the proposed changes. One of the large accounting firms said it was unsure about the possible implications of identifying individual rights as separate assets, particularly for derecognition questions.

(b) an organisation of securities regulators said that it thought that some items recognised as assets and liabilities as a result of current accounting conventions, such as matching income with related costs, would not meet the new definitions. It suggested that existing requirements possibly inconsistent with the new definitions could include, for example, requirements to recognise government grants in profit or loss at the same time as the related costs, and to recognise future decommissioning costs as part of the cost of property, plant and equipment. The respondent asked the Board to clarify whether it intended to allow these possible conflicts with the revised *Conceptual Framework* to remain and, if so, for how long.

(c) a few respondents asked the Board to add a longer-term project to its work plan, or otherwise commit itself, to review the requirements of existing IFRS Standards in the light of changes to the *Conceptual Framework*.

20. Some respondents—including respondents who broadly supported the proposed definitions—had reservations about particular aspects of the definitions:

(a) both the existing and the proposed definitions link the resource or obligation to the entity. So, rather than define an asset or liability (which could exist and be controlled or owed by *any* party), they define 'an asset of the entity' and 'a liability of the entity'. A few respondents—mainly from Europe and Australia—disagreed with this approach. Those respondents thought that assets and liabilities should be defined independently of the entity and that control should instead be a criterion for recognition.

(b) some respondents 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:

(i) some respondents suggested omitting 'as a result of past events', arguing that the focus should be on the existing rights and not how they arose; or that an entity cannot have present control without a past event; or that 'as a result of past events' is included within the description of a present obligation.

(ii) some respondents suggested omitting 'present' on the grounds that this term: is difficult to translate; is unnecessary because a resource controlled by the entity could not be anything other than present; or 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.

(iii) one preparer suggested that neither 'present' nor 'as a result of past events is needed.

21. A few academics and individuals suggested alternative ways of defining an asset and a liability:

    (a) suggestions for the definition of an asset included:

        (i) 'cash or another private economic good';

        (ii) 'financial capital provisionally used by the entity';

        (iii) 'a present right to the services (or uses) of an existing economic resource'; or

        (iv) 'a right'.

    (b) suggestions for the definition of a liability included:

        (i) 'a legally enforceable claim on the entity to transfer cash or other private economic goods (including the provision of services) to fulfil an obligation which has arisen as a result of a past transaction, action or event. Liabilities can include claims resulting from obligations that are entered into for prudential purposes (such as improving the entity's reputation or public image) or moral (ie ethical or social) purposes'.

        (ii) 'an obligation to creditors'.

Comments specific to the definition of an asset

22. A few respondents opposed the proposal to identify rights over physical objects, rather than the underlying objects themselves, as the entity's assets. They argued that such an approach:

    (a) would bring with it additional complexity;

    (b) contradicts the concept of 'substance over form'—in the view of one respondent the economic reality is that an entity has tangible and intangible assets, not packages of rights; or

    (c) could have unintended consequences, such as unnecessarily small units of account.

Comments on the definition of an economic resource

23. Some respondents commented on the proposal to define an economic resource as 'a right', instead of as 'a right or other source of value':

(a) a few respondents explicitly agreed with this refinement to the Discussion Paper proposal, agreeing that the phrase 'other source of value' is too vague.

(b) a few respondents disagreed with the refinement. They argued that the common understanding of the term 'right' does not include these other sources of value, such as know-how, goodwill and cash. The respondents agreed that such items should fall within the definition of an economic resource. They suggested that it would be better to add them to the definition of 'economic resource' than to contrive to extend the definition of 'right' beyond its commonly understood meaning.

GUIDANCE SUPPORTING THE DEFINITION OF AN ASSET

The rights that constitute an economic resource

Exposure Draft proposals (paragraphs 4.8-4.12)

24. The Exposure Draft proposed to define an economic resource as a 'right that has the potential to produce economic benefits'. The Exposure Draft proposed further guidance on the meaning of the term 'right':

> 4.8 Rights that constitute economic resources may take the following forms:
>
> (a) rights established by contract, legislation or similar means such as: [list of examples];
>
> (b) rights arising from the constructive obligation of another party (see paragraph 4.34); and
>
> (c) other rights that give the entity the potential to receive future economic benefits that are not available to all other parties, for example, rights to the economic benefits that may be produced by items such as know-how not in the public domain or customer or supplier relationships (see paragraph 4.20).

25. The Exposure draft further proposed that:

> 4.12 In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single asset, namely the unit of account… In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single item. …

Summary of feedback

26. Commenting on the list of examples of rights that constitute economic resources in paragraph 4.8:

    (a) a few respondents, including an accounting firm and a standard-setter, disagreed that rights could arise from the constructive obligations of other parties. Paragraph 4.34 uses the term 'constructive obligation' to describe obligations that arise from an entity's past practices, policies or statements, and that might not be legally enforceable. The respondents expressed a view that rights must be enforceable, one respondent suggesting that if a right is not enforceable, an entity cannot control that right.

(b) some respondents asked for more discussion of whether and why particular items would meet the definition of 'right', suggesting that such clarification was necessary to understand the intended scope of the term 'right' and the differences between existing IFRS requirements and the *Conceptual Framework* proposals. Items for which more clarification was requested included:

  (i) goodwill. Respondents noted that some of the discussion in the Basis for Conclusions implies that the Board is not intending to narrow the definition of an asset to exclude goodwill. But several—including two large accounting firms—suggested that a more explicit statement is important to avoid uncertainty.

  (ii) the nature of the rights (if any) that an entity might acquire when it incurs some types of costs that are essential to conduct operations or to generate future inflows, such as costs incurred to start a business (including costs required to comply with jurisdictional requirements), exploration costs, or research and development costs.

  (iii) competitive advantages, such as comparatively stronger bargaining power, long-term relationships with customers and comparatively higher marketing, advertising and development activities.

  (iv) conditional rights, such as rights that are pending approval by an authority.

(c) one academic organisation said it did not agree that customer and supplier relationships are assets. It argued that any future economic benefits are not controlled by the entity: they give the hope, rather than the right, to transact future business. That respondent further argued that customer lists are different because they could be sold and provide the ability to carry out a targeted marketing exercise.

(d) an organisation representing preparers of financial statements suggested that the *Conceptual Framework* should include a definition of the term 'right', in addition to the examples listed. The respondent noted that dictionary.com defines a right as a 'just claim or title, whether legal, prescriptive or moral'.

(e) the International Integrated Reporting Council (IIRC) noted that the proposed definition of an economic resource may not include all of the resources and relationships that entities depend on to create value (the 'six capitals' that the IIRC has identified for its integrated reporting model). The IIRC suggested including a note to this effect in the *Conceptual Framework*.

27. Some respondents suggested that the *Conceptual Framework* needs more discussion of the implications of assets being viewed as a set of rights. In particular:

(a) one standard-setter asked for more clarity about the nature of an entity's rights if the entity has joint control of a physical object, or full control of a physical object but only a minority interest in the economic benefits flowing from it. Another standard-setter asked the Board to clarify how an economic resource that is subject to joint control meets the definition of an asset.

(b) the same two standard-setters asked for further discussion of the ways in which an entity's rights can change, for example if an entity loses outright control of a physical object but continues to have joint control of that object. In particular, they suggested adding concepts distinguishing:

(i) situations in which an entity has disposed of some of its rights and retained others (which one standard-setter suggested might occur if an entity leases the right to use an asset to another party for a specified period only); from

(ii) situations in which an entity has exchanged one bundle of rights for a different bundle of rights (which the standard-setter suggested might occur if the entity transfers physical assets to a joint arrangement or associate).

(c) two standard-setters suggested that the individual rights within a set of related rights are not always separate assets: they are separate assets only if they are capable of being separated from the other rights. One of those standard-setters suggested that such a conclusion would be consistent with the Board's conclusions on executory contracts (as explained in paragraph BC4.116(a)). The other suggested that such a conclusion would be inconsistent with the proposal in paragraph 4.62 that separability would be a factor considered in selecting a unit of account.

(d) some organisations representing European preparers of financial statements suggested that the default approach should be that all the rights over a physical asset or intangible asset are accounted for as a single asset, unless some rights are controlled by another party and accounting for such rights separately provides the most relevant information.

(e) one standard-setter suggested that the *Conceptual Framework* should acknowledge that the measurement of a collective bundle of rights accounted for as a single asset is not necessarily the sum of the measurements of the individual rights that collectively form the asset.

28. Paragraph 4.10 of the Exposure Draft proposed that rights of access to public goods are not economic resources for an entity if similar rights are available to all parties without significant cost. Some respondents, although agreeing with the conclusion that rights of access to public goods do not meet the definition of an asset, disagreed with the reasons given in the Exposure Draft. They suggested that those rights of access *are* economic resources, but that the rights do not meet the definition of assets because the economic resources are not *controlled* by the entity. Accordingly, these respondents recommended that the discussion of public goods should be moved from the discussion of 'rights' to the discussion of 'control'.

The meaning of ‘control’ in the definition of an asset

Exposure Draft proposals *(paragraphs 4.17-4.23 and BC4.40-BC4.44)*

29. The Exposure Draft proposed a definition of control that is consistent with the definitions applied to assets in IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*[2]:

> 4.18 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it.

30. The Exposure Draft also proposed to describe the role of ‘risks and rewards of ownership’ in the same way as that role is described in IFRS 15, ie as one indicator of control[3]:

> 4.22 Having exposure to significant variations in the amount of the economic benefits produced by an economic resource may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of control.

31. Finally, paragraph 4.23 of the Exposure Draft proposed a short discussion of agents and principals.

Summary of feedback

32. A few respondents, including an accounting firm and preparers of financial statements, explicitly supported the proposed discussion of control.

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[2] IFRS 15, paragraph 33; IFRS 16 paragraph B9.

[3] IFRS 15, paragraph 38(d).

33. A few respondents disagreed with or questioned aspects of the proposals:

(a) a few respondents noted that the proposed definition is different from that applied in IFRS10 *Consolidated Financial Statements* to identify subsidiaries controlled by a parent entity. They suggested either that the definitions should be aligned or that the Basis for Conclusions should explain how the definitions interact.

(b) one European standard-setter expressed regret that the Exposure Draft does not include more discussion of the notion of 'risks and rewards'. In its view, the paragraph identifying 'risks and rewards' is not sufficiently clear because it merely repeats from IFRS Standards the notion of risks and rewards as an indicator of control, and it does not explicitly use the terminology 'risks and rewards'.

(c) one preparer of financial statements thought that paragraph 4.22 implies that control overrides risk-and-reward considerations and so appears inconsistent with the proposals for derecognition, which do not propose a control approach in all circumstances. That respondent suggested deleting paragraph 4.22.

34. A few respondents commented on the discussion of agency:

(a) some asked for more guidance within the *Conceptual Framework*:

(i) one standard-setter specifically suggested that it would be helpful to have principles for determining whether an entity is acting as an agent.

(ii) an accountancy body suggested providing examples using sales taxes, repurchase agreements and pledged securities.

(b) an individual suggested that the description of principals and agents is different from that in IFRS 15, and thought that determining whether an entity has an asset or a liability purely on the basis of whether the entity is a principal or agent might not provide a faithful representation of the economic activities of the entity.

CONCEPTS FOR SELECTING A UNIT OF ACCOUNT

Exposure Draft proposals *(paragraphs 4.57-4.63 and BC4.112-BC4.116)*

35. The Exposure Draft described the unit of account as:

> the group of rights, the group of obligations or the group of rights and obligations, to which recognition and measurement requirements are applied.

36. The Exposure Draft proposed that:
    (a) a unit of account is selected for an asset or a liability after considering how recognition and measurement will apply, not only to that asset or liability, but also to the related income and expenses;
    (b) the selected unit of account may need to be aggregated or disaggregated for presentation or disclosure purposes;
    (c) in some cases, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement;
    (d) the objective in selecting a unit of account is to provide the most useful information that can be obtained at a cost that does not exceed the benefits; and
    (e) if an entity transfers part of an asset or part of a liability, the unit of account may change at that time so that the transferred component and the retained component become separate units of account.

37. In addition, the Exposure Draft discussed:
    (a) examples of possible units of account; and
    (b) how the objective described in paragraph 36(d) might be met.

38. The Basis for Conclusions on the Exposure Draft explained that the Board believes that the selection of a unit of account is a decision to be taken when developing individual IFRS Standards, not a decision that can be resolved conceptually for a broad range of IFRS Standards. However, in response to comments made on the Discussion Paper, the Exposure Draft provided a more detailed discussion than had been included in the Discussion Paper of the factors that the Board would need to consider when selecting a unit of account.

Summary of feedback

39. Although there was no separate question in the invitation to comment on the concepts proposed for selecting a unit of account, just under a quarter of respondents commented on those concepts.

40. Nearly one-third of the respondents who commented stated that they generally agreed with the proposed discussion on unit of account. Among these respondents, nearly half explicitly supported the proposal that the unit of account should be determined when developing individual IFRS Standards.

41. Some respondents stated that they would like to see more guidance in the *Conceptual Framework*. Suggestions included:

    (a) adding principles for identifying the appropriate unit of account;

    (b) discussing how the unit of account relates to:

        (i) the definition of a reporting entity;

        (ii) the definition of assets (as a bundle of rights);

        (iii) the components approach in IAS 16 *Property, Plant and Equipment*;

        (iv) derecognition of financial assets;

        (v) presentation;

        (vi) embedded derivatives;

        (vii) insurance contracts; and

        (viii) the accounting for individual items and the accounting for the portfolio.

42. In contrast, a few respondents suggested that the guidance on unit of account should be shorter than the guidance proposed in the Exposure Draft.

43. A few respondents expressed a view that the proposed guidance would not be helpful to the Board when developing or revising IFRS Standards. One standard-setter had applied the proposed guidance to selected items and tentatively concluded that the guidance included in the Exposure Draft does not provide clear directions on how to determine the unit of account.

44. Some respondents disagreed with the proposal that the unit of account would be determined *after* considering how recognition and measurement would apply. They stated that it should be determined before then, or at the same time.

45. Regarding the proposal that the unit of account may be different for recognition and measurement:

(a) a few respondents explicitly agreed with this proposal;

(b) some respondents expressed a view that the unit of account for recognition and measurement should always be the same;

(c) one standard-setter suggested that the *Conceptual Framework* should state that the unit of account for recognition and measurement would be the same, but that different conclusions can be reached in individual IFRS Standards;

(d) another standard-setter thought that the *Conceptual Framework* should acknowledge that the unit of account for recognition and measurement would be the same in many cases and that it would be rare to use different units of account;

(e) some respondents suggested that the Board should clarify when different units of accounts may be used;

(f) one standard-setter suggested that Conceptual Framework should clarify that the unit of account for measurement could differ depending on the context (for example, an asset may be componentised for depreciation purposes but valued together with other assets for impairment purposes);

(g) one securities regulator suggested that the *Conceptual Framework* should require that, if the Board decides to apply different units of account for recognition and measurement in a particular IFRS Standard, the Standard should include the rationale; and

(h) one preparer group suggested that the Board should indicate that the unit of account applies only to measurement and not to recognition.

46. A few respondents expressed concern about the proposal that the selected unit of account may need to be aggregated or disaggregated for presentation or disclosure

purposes. These respondents thought that once the appropriate unit of account is selected, that unit of account should also be used for presentation and disclosure purposes.

47. A few respondents asked the Board to clarify whether all the characteristics proposed in paragraph 4.62 of the Exposure Draft (relevance, faithful representation and cost-benefit considerations) need to be present. One of those respondents, a preparer group, further asked the Board to clarify that the ordering of the factors is irrelevant.

48. Regarding the role of the cost constraint in selecting the unit of account:

(a) a few respondents disagreed with including the cost constraint as a factor to consider in determining the unit of account;

(b) one standard-setter stated that the cost constraint may be considered but only after relevance and faithful representation are considered; and

(c) a few respondents stated that it should be the Board that makes cost-benefit decisions, rather than individual preparers.

49. Some respondents disagreed that the discussion of the unit of account should be located in Chapter 4 of the *Conceptual Framework* (elements of financial statements):

(a) a few respondents suggested that the unit of account should be discussed in Chapter 5 (recognition and derecognition);

(b) one standard-setter suggested that it should be discussed as a separate chapter because it is a pervasive concept; and

(c) one accountancy body suggested that it should be discussed with ‘business activities’.

50. One preparer of financial statements supported the link made to ‘business activities’ in the discussion of unit of account. One accountancy firm suggested that the Exposure Draft should draw a link between ‘unit of account’ and the discussions on ‘executory contracts’ and ‘derecognition’.

CONCEPTS ON EXECUTORY CONTRACTS

Exposure Draft proposals (paragraphs 4.40—4.42 and BC4.82—BC4.92)

51. The Exposure Draft described an executory contract as:

> a contract that is equally unperformed: neither party has fulfilled any of its obligations, or both parties have fulfilled their obligations partially and to an equal extent.

52. The Exposure Draft proposed that:

    (a) an executory contract establishes a right and an obligation to exchange economic resources;

    (b) the right and the obligation to exchange economic resources are interdependent and cannot be separated. Hence, the combined right and obligation constitute a single asset (if the terms of the exchange are favourable) or a single liability (if the terms of the exchange are unfavourable);

    (c) whether the asset or liability arising from an executory contract is included in the financial statements depends on both the recognition criteria and the measurement basis adopted for the contract; and

    (d) to the extent that a party fulfils its obligation under the contract, the contract ceases to be executory.

53. The Basis for Conclusions on the Exposure Draft:

    (a) explained why the Exposure Draft proposes that an executory contract establishes a right and an obligation to exchange economic resources rather than a separable right and obligation;

    (b) described the implications of the proposed approach to executory contracts for lease contracts and 'trade date accounting'[4]:

[4] IFRS 9 *Financial Instruments* permits 'trade date accounting' for a 'regular way' purchase or sale of a financial asset. This treats the financial asset as having already been delivered at the commitment (trade) date, instead of accounting for the purchase or sale contract as a derivative until settlement.

(i) a lease contract is no longer an executory contract once the lessor has delivered the right-of-use asset to the lessor;

(ii) ‘trade date accounting’ is a simple and practical method of managing and recording transactions that only have a short duration and, hence, is justified on cost-benefit grounds.

(c) explained why the Board expects that the current practice of not recognising many executory contracts is likely to continue—measurement of an executory contract at its historical cost usually results in the contract being measured at zero (which has the same practical effect as not recognising the contract).

Summary of feedback

54. The invitation to comment on the Exposure Draft did not include a specific question on the concepts proposed on executory contracts. However, some respondents provided comments on those concepts.

55. Some respondents, including some standard-setters and preparers, explicitly agreed with the proposed concepts.

56. However, some respondents disagreed with the proposal in the Exposure Draft that an executory contract establishes a right and an obligation to exchange economic resources. These respondents expressed the view that executory contracts give rise to a separate right and separate obligation. There were different views about the appropriate unit of account for this right and obligation:

(a) the separate right and separate obligation should be treated as giving rise to a separate asset and a separate liability;

(b) the separate right and separate obligation should be treated as a single unit of account;

(c) the separate right and separate obligation should either be treated as a separate asset and separate liability or combined into a single unit of account depending on which treatment provides the most relevant information.

57. One standard-setter disagreed with the proposed concepts and argued that the proposal to treat executory contacts as an inseparable right and obligation to exchange economic resources that gives rise to a single asset or liability is inconsistent with the proposed definition of an asset and a liability. That standard-setter noted that nothing in the Exposure Draft states that a right and an obligation must be separable in order to result in an asset or liability. In addition, it noted that the Board rejected using separability as a criterion for the recognition of an asset.

58. Some respondents asked the Board to clarify how the proposed recognition criteria would apply to the identified right and obligation arising from executory contracts. Some of those respondents expressed concern that the proposed concepts could result in more executory contracts being recognised and they disagreed with this outcome. A few respondents suggested that the *Conceptual Framework* should provide guidance on when recognition of executory contracts would provide useful information. Others suggested that assets or liabilities arising from executory contracts should not be recognised, because recognising them would be costly, complex or fail to provide useful information to users of financial statements.

59. A few respondents suggested that the proposed concepts for executory contracts might not be consistent with the principles for the recognition of contract assets and performance obligations in IFRS 15. We will analyse these comments at a future meeting. However, the staff note that IFRS 15 mostly addresses how to account for contracts that are no longer executory.

60. Some respondents suggested that the concepts on executory contracts in the Exposure Draft are unclear. Some of them suggested that the explanation could be improved by moving some of the material from the Basis for Conclusions to the *Conceptual Framework* itself. In particular, some suggested including in the *Conceptual Framework* the explanation of why many executory contracts are not currently included in the financial statements.