

International Financial Reporting Standards

World Standard-setters Meeting
23 September 2013

Small group discussions

Asset and liability
definitions and recognition



Discussion Topic 1

‘Present’ obligation—the impact of an entity’s future actions

View 1

An obligation that:

- arises from past events, and
- is **strictly** unconditional.

The entity has **no** ability to avoid the transfer through its future actions.

View 2

An obligation that:

- arises from past events, and
- is **practically** unconditional.

The entity does not have **practical** ability to avoid the transfer through its future actions.

View 3

An obligation that:

- arises from past events, and
- may be **either** unconditional **or** conditional on the entity's future actions.

On meeting any further specified conditions, the entity will have to transfer an economic resource that it would not have had to transfer in the absence of the past events.

The amount of the future transfer is determined by reference to benefits received, or activities conducted, by the entity before the end of the reporting period.

Scenario A

Levy on revenues above a threshold

A government charges a levy on entities that operate trains on the national rail network. The levy is charged at the end of each calendar year. The levy is 1 per cent of revenue earned in the year in excess of 500 million currency units (CU). A train operator is preparing financial statements for its financial reporting year to 30 June. It has earned revenue of CU450 million between 1 January and 30 June. It expects to have earned revenue of CU900 million by the end of the calendar year and hence to be charged a levy of CU4 million* for the year.

* (CU900 million – CU500 million) x 1%

Questions for discussion

1. Has the necessary 'past event' occurred?
2. Is there a present obligation applying:
 - View 1
 - View 2
 - View 3?
3. Do *you* think a present obligation exists in this scenario? Why or why not?

Scenario B Contingent consideration

A contract for the sale of a business requires the acquirer to make an additional payment of CU5 million to the seller if the acquired business meets specified earnings targets in the three years after acquisition.

The acquirer is preparing financial statements at the acquisition date. Available evidence suggests that it is highly likely that the acquired business will exceed the earnings targets.

Questions for discussion

1. Has the necessary 'past event' occurred?
2. Is there a present obligation applying:
 - View 1
 - View 2
 - View 3?
3. Do *you* think a present obligation exists in this scenario?

Discussion Topic 2

Asset and liability definitions—impact of uncertainty

Existence uncertainty

Uncertainty about whether a right or obligation exists.

Existence uncertainty

- occurs in limited circumstances.
- if significant for a particular asset or liability, IASB would decide how the uncertainty should be dealt with when developing applicable IFRS.
- conceptual Framework should **not** set a probability threshold.

Outcome uncertainty

Uncertainty about whether an existing right or obligation will result in an inflow or outflow of economic benefits.

Outcome uncertainty

- does not affect existence of asset or liability.
- so definitions should omit requirement for right or obligation to be **expected** to result in inflows or outflows.
- BUT outcome uncertainty might affect conclusions about whether asset or liability should be recognised (page 11).

Scenario C—Lawsuit in progress

Entity X is suing entity Y for damages resulting from alleged negligence. At the reporting date, it is uncertain whether, and to what extent:

- Entity X has a right to receive damages, and
- Entity Y has an obligation to pay damages.

The available evidence suggests that it is slightly more likely than not (ie slightly more than 50% likely) that the court will find in favour of entity X. However significant uncertainty remains.

Questions for discussion

1. Do you agree that the Conceptual Framework should *not* set a probability threshold for identifying an asset or liability in situations of existence uncertainty?
(Any threshold would be set in the applicable standard, eg IAS 37.)
2. If you think that the Conceptual Framework *should* set a threshold, what do you think that threshold should be?
 - 0% (the measurement would reflect the uncertainty)?
 - More likely than not, ie more than 50%?
 - Virtually certain?
 - Higher for assets (eg entity X's right) than for liabilities (eg entity Y's obligation)?
 - Higher for assets or liabilities generated through the entity's own activities than for those acquired in an exchange transaction?

Examples of assets subject to outcome uncertainty

A traded option held—it is certain that the entity has the right to exercise the option and cash flows will occur if it does so, but uncertain whether the entity *will* exercise the option (ie whether the option will be in the money at expiry).

Know-how generated by a research and development project. This asset will generate cash if the project is successful or the know-how is sold. The probability of success is unknown, and there is a wide range of possible outcomes.

A lottery ticket—it is certain that the holder has a right to participate in the draw. The probability of receiving winnings is very small (but measurable if the total number of tickets is known).

Question for discussion

Do you agree that an asset exists in all of these examples—ie irrespective of the probability of future cash inflows?

At this stage, please consider only whether an asset exists. You will discuss later whether any identified asset should be recognised.

Discussion Topic 3

Recognition of assets and liabilities

An entity should recognise all of its assets or liabilities, unless the IASB decides that:

- recognising a particular asset or liability would provide information that is not relevant, or is not sufficiently relevant to justify the cost;
- or
- no measure of the asset or liability would result in a sufficiently faithful representation of both:
 - the asset or liability, and
 - the resulting income or expense.

Perhaps if:

- extremely wide range of outcomes, and likelihood of each outcome exceptionally difficult to estimate,
- low probability of inflow/outflow, and users unlikely to include information about inflow/outflow in their analyses,
- unusually difficult to identify resource/obligation,
- exceptionally subjective allocations of cash flows required to measure resource/obligation, or
- recognition not necessary to meet objectives of financial reporting (eg internally generated goodwill).

Scenarios

Lawsuit in progress—
as described on page 8.

Traded option held—
as described on page 9.

Know-how—
as described on page 9.

Lottery ticket—
as described on page 9.

Questions for discussion

1. Do you think that an asset or a liability should be recognised in these scenarios? Why or why not?
Assume that the IASB has concluded that an asset or liability exists in each scenario.
2. Do you think that the Discussion Paper preliminary views (see previous page) would lead to the IASB to the same conclusions?