



Board Meeting Handout

December 19, 2007

Intangible Assets Agenda Proposal

PURPOSE

Consistent with the February 2006 Memorandum of Understanding, the objective of this meeting is for the Board to discuss whether to add a project to its agenda to address the accounting and reporting for intangible assets. The Board will consider the scope of the proposed project and whether the project, if undertaken, should be conducted collaboratively with the IASB.

BACKGROUND

At the April 2007 joint meeting, the Boards discussed a draft pre-agenda package for a possible project on accounting for intangible assets. That draft was prepared by the staff of the Australian Accounting Standards Board (AASB). On November 30th, the Board received the updated final version to that proposal. See the IASB's December 2007 [Observer Notes](#) (Agenda Paper 5A) for a public version of the proposal. As noted in the executive summary of the proposal, the staff of the AASB:

...think that the relative urgency with which an Intangible Assets project should be initiated should have regard to the views of the SAC and FASAC and Criterion 5 *resource constraints*. Based on our assessment of the agenda criteria, our view is that an Intangible Assets project should be added to the Boards' active agendas **as soon as resources are available to commit to such a project**. The scope of the project should be the initial accounting for identifiable intangible assets other than those acquired in a business combination (with a focus on, but not limited to, internally generated intangible assets) and the subsequent accounting for all identifiable intangible assets. The technical objective of such a project should be to identify appropriate recognition, measurement and presentation/disclosure requirements. In relation to measurement issues (cost versus fair value), we think that they should be resolved as part of the project process, rather than as part of the agenda decision process. If the Boards conclude that resources are not available to undertake such a project now, we would prefer that the project is delayed until resources become available. [Emphasis added.]

The IASB, on November 8, 2007, discussed the proposed project with its Standards Advisory Council (SAC). As noted in paragraph 42 of the proposal:

...although some SAC members acknowledged the importance of intangible assets, there was concern about the practical and conceptual complexities involved, including measurement and implications for the *Framework*. One comment was made that IAS 38 is working and does not create too many problems, and therefore it is too early to undertake an intangible assets project. Another comment made is that the project would not meet the IASB's strategic

objective to get more countries adopting IFRSs. Only two SAC members voted in favour of adding intangible assets to the IASB agenda.

The IASB considered the proposal at its December 12, 2007, meeting and decided not to add a project to its agenda at this time. In general, IASB members acknowledged the importance of the unresolved issues surrounding intangible assets and concurred that a comprehensive undertaking would entail significant resources; however, this is not viewed as among the most urgent of matters to be addressed with the limited resources available. Some members also expressed the view that the Board needs to address more fundamental matters (perhaps through its conceptual framework project) before it would be capable of comprehensively addressing intangible assets. Some members also asked the Directors to inquire further as to whether a group of national standard setters might take up further research efforts.

The FASB discussed the proposed project with its Financial Accounting Standards Advisory Council on December 6, 2007 and its Investors Technical Advisory Committee on September 6, 2007. FASAC members acknowledged the importance of intangible assets but the consensus view was that this is not among the most urgent matters to be addressed by the FASB. ITAC members expressed mixed views of the usefulness of intangible asset information in the primary financial statements, but they generally agreed that more disclosures could be useful, particularly in certain industries. However, given resource constraints, all but one member felt that the potential project was of a lower priority.

QUESTION FOR THE BOARD

Does the Board want to add a project on intangible assets to its agenda? If so, what would be that project's objective(s) and scope?



**Board Meeting Handout
Conceptual Framework**

December 19, 2007

At today's meeting, the Board will first discuss whether to more closely align the approach to developing a definition of a liability with alternatives described in the Board's recently released Preliminary Views on Financial Instruments with the Characteristics of Equity. The Board will consider whether to focus on defining the broader class of items that would be candidates for inclusion on a Statement of Financial Position as either liabilities or equity, and subsequently sub-dividing that broader class into those that constitute liabilities and those that constitute equity. In a similar discussion last week, the IASB confirmed its intent to continue with converging and improving the definition of a liability, based on the Board's previous decisions to converge and improve the definition of an asset. Prior to the issue of a document for comment, the resulting definitions of liability and equity in the Conceptual Framework project will need to be reconciled with those being considered in standard projects.

Second, the Board will discuss converging and improving the working definition of a liability or a definition of a broader class of items by first considering liability-type items. Items with equity characteristics will be considered later. The discussion will focus on identifying the key concepts required in the definition, rather than on which terms more clearly communicate those concepts. Discussion on whether such items should be recognized, uncertainty of items, and distinguishing those items that are liabilities and those that are equity will take place at later meetings.

CONVERGING THE DEFINITIONS

1. The existing IASB and FASB definitions of a liability are as follows:

A liability is 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. [IASB *Framework*, paragraph 49(b)]

Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to

other entities in the future as a result of past transactions or events. [FASB, CON 6, paragraph 35; footnote references omitted.]

Present Obligation versus Probable Future Economic Sacrifices

2. There are several wording differences between the definitions, but the key difference is that the IASB definition focuses on a liability as being a *present obligation*, whereas the FASB definition focuses on liabilities as being *probable future sacrifices of economic benefits*.
3. The staff thinks that the definition of a liability should focus on stocks—the things that exist. A liability is not itself an outflow (or sacrifice) of economic benefits, but rather it is something that is capable of resulting in an outflow (or of reducing an inflow). Additionally, a liability is something that exists in the present rather than in the future.
4. The key convergence change proposed is the use of *economic obligation* rather than *sacrifices of economic benefits* to indicate that the focus is on a stock, rather than on a flow, and the use of *present* rather than *future* to indicate that the resource must presently exist. By making this change we could converge the definitions of a liability as follows:

<p>“A <i>liability</i> is a present economic obligation of the entity as a result of past [transactions or other] events from which future economic benefits are expected to flow from the entity.”</p>

FURTHER IMPROVING THE DEFINITION

Likelihood

5. Both of the existing IASB and FASB definitions of a liability make reference to likelihood, but use different words (“expected” in the case of the IASB and “probable” in the case of the FASB). Both definitions have been misinterpreted as implying that there must be a high likelihood of future outflow of economic benefits for the definition to be met.
6. If there is any question of likelihood to be considered, that might be a factor in assessing whether a particular liability (or liability class) qualifies for recognition, or in determining its measurement, not in the definition of a liability.

7. This suggests that the staff should further amend the converged definition of a liability as follows:

“A *liability* is a present economic obligation of the entity as a result of past [transactions or other] events from which future economic benefits are capable of flowing ~~expected to flow~~ from the entity.”

Linking the Definition to the Objective of Financial Reporting

8. Neither the existing IASB framework nor the FASB framework explicitly ties the liability definitions to the objective of financial reporting—to provide information useful to users in making resource allocation decisions, such as information to assess the timing and uncertainty of future cash flows.
9. Thus, to better tie the liability definition to the objective of financial reporting, the staff thinks that it is preferable to focus directly on the capability of *requiring cash outflows or reducing cash inflows*. This suggests that we should further amend the converged definition of a liability as follows:

“A *liability* is a present economic obligation of the entity as a result of past [transactions or other] events that is capable of resulting in cash outflows or reduced cash inflows ~~from which future economic benefits are capable of flowing from the entity.~~”

10. This formulation of the definition is not clear as to whether the phrase *that is capable of resulting in cash outflows or reduced cash inflows* constitutes further explanation of what is an economic obligation or is a narrowing of that term to a particular type of economic obligation. The staff thinks that the intent of the phrase is to further explain what an economic obligation is and, therefore, that it is clearer not to include the phrase in the definition. The staff thinks that the FASB should accompany the definition of a liability with separate definitions of key terms. In that way, a complete description can be more readily provided without overburdening the wording of the definition of a *liability*. Thus, the definition of a liability becomes:

“A *liability* is a present economic obligation of the entity as a result of past [transactions or other] events ~~that is capable of resulting in cash outflows or reducing cash inflows.~~”

Past Transaction or Other Event

11. Both the existing IASB and FASB definitions refer to the need for an asset and a liability to have arisen as a result of something having happened in the past. By focusing on a *present* economic obligation in the proposed definition of a liability, it becomes redundant to refer to the need for a past event. This suggests that we should further amend the definition of a liability as follows:

“A <i>liability</i> is a present economic obligation of the entity as a result of past transactions or other events.”
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Questions for the Board:

12. **Parallel with the changes made to the working definition of an asset, does the Board agree that the existing IASB and FASB liability definitions should be:**
- Converged to focus on defining a liability as an economic obligation rather than as probable future sacrifices**
 - Improved by removing the assessment of likelihood**
 - Improved by replacing references to past transactions or other events, with a focus on the present**
 - Does the Board think that any further improvements should be considered (see below), or do you think that the staff should stop here?**

HOW TO DESCRIBE A LIABILITY (A “BAD THING”)

Opposite Term of *Economic Resource*

13. Previously, the staff had proposed the term “economic burden” as the opposite of “economic resource.” In light of concerns about the word *burden*, the staff has sought out alternative words, such as “encumbrance,” “onus,” “duty,” “responsibility,” or “requirement.” On balance, the staff thinks that *economic burden* and *economic requirement* most clearly capture the opposite of “economic resource.”

14. To follow a parallel approach used in the working definition of an asset and to describe the first essential component of a liability, the staff suggests to further amend the definition of a liability as follows:

“A *liability of an entity* is a present economic burden or requirement¹ ~~obligation~~ of the entity.”

15. To communicate the meaning of *economic burden or requirement*, the definition of a liability should be accompanied by the following definition:

“An *economic burden or requirement* is something that is scarce and capable of resulting in cash outflows or reduced cash inflows, directly or indirectly, alone or together with other economic burdens or requirements.”

Question for the Board:

16. Does the Board agree that the definition of a liability should describe the “bad thing” as an economic burden or requirement and that the definition of an economic burden or requirement should be provided?

DESCRIBING HOW THE ENTITY IS “LINKED” TO THE ECONOMIC BURDEN OR REQUIREMENT

The Term *Obligation*

17. The difficulty with the term *obligation* is that accountants use the term with three different meanings. That is, *obligation* is commonly used to mean:

- a. A “bad thing”
- b. The linkage between an entity and the “bad thing”— the natural counterpart of *right* is *obligation*, especially in the context of contracts, as in “contractual rights and obligations”
- c. A combination of (a) and (b)—that is, as a synonym for *liability*.

Even though obligation is still subject to the misinterpretations previously described, many of the synonyms for obligation are also subject to the same misinterpretations. The staff thinks

¹ The staff has suggested using both *burden* and *requirement* in the working definition. However, if the Boards agree that one or the other tem is clearly preferable, then that term might be used alone.

that it will be more worthwhile to focus the improvements on identifying and explaining the two essential components of a liability, then replacing an entrenched term like *obligation*.

18. Consistent with the approach in the asset definition to restrict rights to those that are enforceable, the staff proposes that the definition of a liability should also limit obligations to those that are enforceable by legal or other equivalent means. Therefore, to clarify the use of *obligation* in the liability definition, the staff proposes to describe the obligation as being *enforceable* and to define this key term. This suggests that the definition of a liability should be amended further, as follows:

“A <i>liability</i> of an entity is a present economic burden or requirement <u>to which</u> of the entity <u>has an enforceable obligation</u> .”
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19. To communicate the intended meaning of *enforceable obligation*, the definition of a liability should be accompanied by the following definition:

“An *enforceable obligation* establishes the link between the entity and the present economic burden or requirement. Obligations are legally enforceable or enforceable by equivalent means.”

Question for the Board:

20. **Does the Board agree with the definition of a liability in paragraph 18 and the definition of enforceable obligation?**

Equivalent to *Other Means* of Access in Definition of an Asset

21. The working definition of an *asset* establishes the link between the entity and a present economic resource by describing the link as being established *through an enforceable right or other means*. *Other means* in the working definition of an asset is intended to capture situations in which an entity’s link to a present economic resource is established by other than legally or equivalently enforceable means—that is, there is no other party that can enforce the entity’s link, but the entity can protect its link by means of barriers to access, such as secrecy. Effectively, in these situations, the entity protects its ownership of the economic resource. Therefore, this type of asset is more akin to those assets for which the entity has ownership, or property rights, for which there are no corresponding liabilities.

Therefore, the staff thinks that there is no need for an equivalent to *other means* in the working definition of a liability.

Question for the Board:

22. **Does the Board agree that there is no need for an equivalent to “other means” in the proposed definition of a liability? If not, why not?**

ENFORCEABILITY

How *Enforceable* Must an Obligation Be?

23. The staff thinks that existence of an obligation to an economic burden or requirement should not involve assessing to what degree the item is enforceable by others upon an entity. Including such an assessment would result in similar interpretation issues as those that arise with *likelihood* today.
24. The staff thinks that one should consider whether the obligation for the economic burden or requirement is **capable** of being enforced upon the entity through legal or other equivalent means. This is consistent with what an entity commonly considers when making business decisions—a greater than zero ability of another entity to enforce an economic burden or requirement upon the entity.

Question for the Board:

25. **Does the Board agree that enforceable obligations are those that are capable of being enforced and should not involve assessing to what degree the item may be enforceable by others upon an entity? If not, why not?**

What Constitutes *Enforceable by Equivalent Means*

26. The definition of an enforceable obligation includes obligations that are enforceable by means that are equivalent to legal enforceability. *Enforceable by equivalent means* has a couple of essential factors in common with legally enforceability.
- a. *A separate party* is involved.

- b. *Mechanism* exists that is capable of forcing an entity to take a specified course of action or consequence. If that specified course of action is not taken by the entity, then the claimant or intended recipient of the action can seek assistance from the separate party to enforce the consequences.

27. The application of the *enforceable by equivalent means* concept may result in apparently similar obligations qualifying as obligations for financial reporting purposes in one legal and operating environment, but not in another, different environment. The staff believes that an analysis of what enforceable means, both legally and by other equivalent means, should be provided in the amplifying text to the definition of a liability.

Questions for the Board:

28. **Does the Board agree that the factors identified in paragraph 26 describe the essential attributes of “legally enforceable or enforceable by other equivalent means”? Are there any additional factors that should be included?**

29. **Does the Board agree that “legally enforceable or enforceable by other equivalent means” should be described as outlined above in the amplifying text to the definition of a liability? If not, why not?**

SUMMARY OF RECOMMENDATIONS

30. The staff recommends the following definition of a liability:

“A <i>liability</i> of an entity is a present economic burden or requirement to which the entity has an enforceable obligation.”
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31. To provide additional guidance on the two key terms in the working definition of a liability, the staff proposes that the following definitions be provided:

“An *economic burden or requirement* is something that is scarce and capable of resulting in cash outflows or reduced cash inflows, directly or indirectly, alone or together with other economic burdens or requirements.”

“An *enforceable obligation* establishes the link between the entity and the present economic burden or requirement. Obligations are legally enforceable or enforceable by equivalent means.”

32. It is requested that the Board agree to the tentative working definition of a liability for use as the staff proceed with other aspects of Phase B of the Conceptual Framework project.



Board Meeting Handout

Accounting for Depreciable Assets Classified as Held-for-Sale When an Equity Method Investment is Obtained

December 19, 2007

The purpose of this meeting is to (a) summarize the comment letters received on the proposed FSP, (b) address the issues that were raised by the respondents, and (c) request that the Board decide whether to move forward to the ballot process or to remove the project from the Board's agenda.

BACKGROUND

On October 26, 2006, the Board issued proposed FSP FAS 144-c, *Accounting for Depreciable Assets Classified as Held-for-Sale When an Equity Method Investment is Obtained*. The public comment period for the proposed FSP ended on December 15, 2006. The scope of the FSP includes two types of transactions. Those two transactions are (a) exchange of long-lived assets for an equity investment in the buyer or another entity and (b) sale of a portion of the long-lived assets and the selling entity accounting for its remaining interest in those assets as an equity method investment.

COMMENT LETTER ANALYSIS

The FASB staff received four comment letters from each of the Big Four accounting firms. Respondents questioned whether the guidance in paragraph 30(d) of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, had been met since an entity is selling a partial interest in a long-lived asset while still retaining significant influence over the asset through the equity method investment. The respondents were concerned that under the FSP, as proposed, since the long-lived asset would be classified as held-for-sale, an entity would also cease depreciation on the retained portion of the long-lived asset. An entity that applies the carryover method would have a basis difference and catch-up adjustment for depreciation once the long-lived asset was sold and the entity accounted for the retained portion using the equity method. Respondents observed that it would be counterintuitive to cease depreciation while the asset is held-for-sale, only to resume depreciation once the partial sale is

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complete. Therefore, the respondents believe that the transaction should not qualify for recognition as a completed (or probable) sale of the long-lived asset. Respondents also questioned whether the guidance in paragraph 30(b) of Statement 144 had been met, since the level of negotiations required for a selling entity to retain significant influence over the long-lived asset being sold could call into question a conclusion that the long-lived asset is available for immediate sale.

The staff also received other comments related to scope, transition, and the accounting recognition for the equity method investment subsequent to the sale of the long-lived asset. The staff considered each of these comments and determined that they had either been discussed and resolved at a prior Board meeting or were a concern related to the drafting of the proposed FSP, which will be addressed as a part of the drafting of the final FSP.

STAFF ANALYSIS

The staff believes that the decisions reached in FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, clarify the main concerns raised by the respondents in the comment letters. Statement 160 states that when a parent retains a noncontrolling equity investment in a former subsidiary, that investment should be measured at its fair value.

The staff also observes that remeasuring any retained investment to fair value is consistent with the requirements of FASB Statement No. 141 (revised 2007), *Business Combinations* (as proposed), for remeasuring any previously held equity interest in an entity if the acquirer obtains control of that entity in a business combination achieved in a step acquisition.

The staff believes that based on the conclusions in Statement 160 the retained investment being recognized in the proposed FSP would constitute a new basis event. This new basis event would require that a gain or loss be recognized. That is, the noncontrolling interest in the asset will be carried at fair value, not depreciated, and subject to impairment testing.

The staff discussed Statement 160 with the respondents who disagreed with the conclusions in the proposed FSP. Those respondents indicated that the guidance in Statement 160 would address their concerns since a gain or loss will be recognized on the retained investment due to the remeasurement of the retained investment to fair value. They also indicated that since this basis difference is not tied solely to depreciation because it is a valuation event and not an allocation of depreciation, it would alleviate their concerns about the adjustment for catch-up depreciation. Respondents still questioned what to do in fact patterns where individual assets are exchanged for investments accounted under the equity method since Statement 160 does not address this issue. However, the majority of the respondents noted that these exchange transactions are not prevalent in practice today.

STAFF RECOMMENDATION

The staff recommends the removal of this proposed FSP from the Board's agenda, since, based on the staff's view; the majority of the issues raised have been addressed by the conclusions reached in Statement 160. For transactions not addressed by Statement 160, the majority of the respondents concluded that these transactions are not prevalent in practice; therefore, it is the staff's position that it is not necessary to issue additional guidance.

QUESTIONS FOR THE BOARD

Question 1—Does the Board agree with the staff recommendation to remove the project from the Board's agenda?

Question 2—If the Board is not in agreement with the staff recommendation, does the Board agree with the conclusions reached in the proposed FSP and to proceed with the final issuance of the proposed FSP?