

MINUTES



To: Board Members
From: Project Team (Chesney x447)
Subject: Minutes of the December 19, 2007
Conceptual Framework Board Meeting **Date:** January 6, 2008
cc: Leisenring, Bielstein, Golden, MacDonald, Allen, Posta, Glotzer,
Klimek, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton,
Hickey, Crook, Lian, Hague, Villmann, Willis, GASB: Reese

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Phase B: Elements and Recognition

Basis for Discussion: Memorandum Nos. 70A & 70B

Length of Discussion: 8:30 a.m. to 9:15 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier, Seidman,
Smith, and Young

IASB members present: Leisenring

Staff in charge of topic: Villmann and Hague

Other staff participating: Beckendorff, Bielstein, Bossio, and L.T.
Johnson

Summary of Decisions Reached:

The Board considered whether to modify its approach to developing a definition of a liability for purposes of the improved conceptual framework to more closely align that definition with alternatives being considered in the Board's recently released *Preliminary Views on Financial Instruments with the Characteristics of Equity*. The Board considered an approach that would initially focus on defining the broader class of items that would be candidates for inclusion in a statement of financial position as either liabilities or equity, and subsequently sub-dividing that broader class into those items that constitute liabilities and those that constitute equity.

The Board suggested testing the working definition of a liability against examples that have characteristics of both liabilities and equity to help ensure that the conceptual definitions being developed will be compatible with the proposals in the liabilities and equity project.

The Board tentatively decided that the IASB and FASB definitions of a liability should be converged by focusing on defining a liability as an economic obligation, rather than as probable future sacrifices; and should be improved by:

1. Removing the assessment of likelihood
2. Replacing references to past transactions or other events with a focus on the present.

The IASB separately discussed the above changes to converge and improve the definitions of a liability and reached similar decisions.

Objective of Meeting:

The objective of the meeting was to 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 objective was also to identify key concepts that should be included in the definition. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

LIABILITY DEFINITION APPROACH AND CONVERGING THE DEFINITION

1. Rebecca Villmann stated that Board members have suggested that the approach to define a liability should be revised in order to maintain consistency with the alternatives developed in the liabilities and equity project. The proposed approach would involve defining a broader class of items that would be candidates for inclusion on a Statement of Financial Position as either liabilities or equity and then sub-dividing that broader class into those that constitute liabilities and those that constitute equity.
2. At last week's meeting, the IASB voted to proceed as previously planned, not as proposed today. However, Ms. Villmann noted that the IASB specified that the resulting definitions of liability and equity in the conceptual framework project would need to be reconciled with those being considered in standards projects. The IASB had strong concerns that additional staff work would be required to realign the approach for this project with that of standards projects, delaying the timetable for the conceptual framework. Regardless of the approach, the IASB felt that the same difficult issues would need to be addressed.

Board Tentative Decision

3. The Board decided that the staff should proceed as previously planned and meet with a subset of FASB and IASB Board members to discuss possible modifications to those plans once they have been further developed. The Board also decided that the working definition should be tested against examples to evaluate the compatibility of the conceptual definitions developed with the Preliminary Views of the liability and equity project.

Board Comments

4. Mr. Herz suggested to first focus on distinguishing business risks from recognizable items and then issue a Preliminary Views document to seek comments on that distinction. Ms. Seidman noted that the conceptual

framework project has focused on whether there is a liability to recognize, while the liability and equity project has determined that there is an enforceable arrangement to recognize. Ms. Seidman stated that distinguishing between a business risk and a liability would later help enhance and converge the views developed in the conceptual framework and standards projects.

5. Mr. Leisenring stated that the IASB did not think that defining the right side of the balance sheet would be helpful in defining liability and equity, but rather that it would likely raise more questions. Mr. Leisenring stated that the liability and equity document has a focus different from this project. (The liability and equity document focuses on defining equity. The framework project focuses on defining an asset and a liability, with equity as the residual.) Mr. Linsmeier noted that, in his view, the current approach of the conceptual framework project would not result in a definition that sufficiently addresses financial instruments with characteristics of both liability and equity. The liability and equity project team and the conceptual framework project team should work together to first define the elements on the right side of the balance sheet.
6. Mr. Bossio noted that the liability definition cannot be completed without looking at the equity definition. Perhaps a definition of the broader class of liability and equity would be useful for developing the thinking behind determining liability and equity; the broader definition may not be part of the final elements definitions.
7. Mr. Hague clarified that the IASB voted not to first determine the items that could be considered liability and equity and then subsequently sub-dividing those items, which is the approach suggested at the FASB's education session held the day before the IASB meeting in London. The IASB voted by a significant margin to pursue the approach originally planned, which is to define a liability and then determine the bounds by which items would be included on the right side of the balance sheet. Ms. Bielstein noted that the IASB also plans to develop a preliminary view of the elements definitions that encompasses the alternatives included in the liability and equity project. The important thing to remember is that both Boards have the same end goal.

8. Ms. Seidman clarified that she agreed with the IASB's vote to continue working on the liability definition. She suggested rephrasing the notion of "burden" so that it is broad enough to encompass the liability and equity preliminary view.
9. Mr. Young stated that the entire right side of the balance sheet should be defined first; an entity has to have capital from external providers, but this capital does not have to be debt.
10. Mr. Herz stated that he would not be in favor of a definition that boxes in the Boards' thinking about these items. Mr. Linsmeier noted that the way to avoid a limiting definition is to test it against items that are not pure liabilities and those that are on the borderline of liability and equity. In order to do that, both project teams need to work together.
11. Mr. Herz suggested getting a small group together to discuss the approaches to avoid papering over differences at such an early stage.
12. Ms. Villmann stated that, in its discussions on the framework project, the IASB agreed to focus on an economic obligation rather than probable future sacrifices, remove the assessment of likelihood, and replace references to past transactions or other events with a focus on the present. The IASB also agreed to two essential concepts to distinguish enforceability, which are a second party and a mechanism of enforcement.
13. Mr. Smith asked if the IASB agreed with the definition developed by the staff. Ms. Villmann noted that the IASB did not vote on specific wording. Mr. Leisenring noted that there was a general distaste for "economic burden." Mr. Linsmeier said that a burden notion could be a problem, and that "scarcity" could be an issue as well. Mr. Hague noted that the staff is planning to remove scarcity from the definition of economic burden or requirement.
14. Mr. Herz asked if the staff intended to convey that an economic obligation is a bad thing. Mr. Johnson noted that an entity might have obligations that would not be liabilities, which is why the staff included "burden" in the definition. Mr. Linsmeier noted that additional text amplifying the definition could explain the burden notion.

15. Mr. Leisenring noted that there will be tension around the definition as to what an entity is obligated to do. Currently, a liability is an obligation to deliver an asset. Using the working definition of an asset, a liability would be an obligation to deliver an economic resource. Based on the FASB's Preliminary Views, an obligation could be to provide an economic resource from the perspective of the recipient; the FASB's narrow view of equity could follow from this view of a liability. This approach to defining equity would not require the entity to assess whether equity holdings have been diluted and does not raise measurement issues. Mr. Linsmeier noted that defining a liability in this way would not work for puttable shares or perpetual preferred stock, as cash flows will be used to settle the first instrument and the latter instrument would not be required to be settled. Mr. Leisenring suggested separating the put from the shares as a way to solve this issue. Mr. Linsmeier stated that such a solution was not in the Preliminary Views document but is an option that could be considered. All models have this difficulty.
16. Mr. Herz noted that it seemed the Board agreed on the concepts in the liability definition, but that some items defined as liabilities by the working definition might also be defined as equity. Mr. Herz said that the FASB did not want this stage of the project pre-determining the line between liability and equity.
17. Mr. Linsmeier stated that it would not be the best use of the staff's time to proceed with both approaches. He suggested that the staff use instruments with characteristics of both liability and equity as illustrations of the liability definition. From there the staff could determine whether one approach would be more favorable than the other.
18. Mr. Leisenring stated that the main issue is whether the obligation is exclusively to deliver an asset, or if it is broader. The IASB is concerned that the absence of a liability definition would make anything not meeting the equity definition by default a liability. Mr. Linsmeier noted that it is absolutely important to draw the line between what is an asset and what is a liability or equity. Mr. Leisenring said that other features such as what is meant by "obligation" must be made clear before the line can be determined.

19. Mr. Herz summarized that, ignoring the issue of whether financial contracts are liabilities or equity, the Board agreed with the direction of the improvements to the liability definition. The main issue is whether constituents will interpret the liability definition as drawing a line between liability and equity that is different from the line proposed in the liability and equity Preliminary Views. The staff will test the definitions against the alternatives and examples listed in the Preliminary Views document. Mr. Hague said that there may be conclusions that are different from those in the Preliminary Views, and that the reasons for such differences would have to be reconciled.
20. Ms. Bielstein clarified that the staff would focus on the definition of a liability and see if it can accommodate the alternatives in the liability and equity project. If that approach did not work, the staff could consider the other approach. Mr. Hague said that the staff can reconcile the two approaches, but the staff needs to do some work before knowing which approach would be best to pursue. Ms. Bielstein agreed that the staff needs to do more work and then meet with Board advisors from both Boards within the next month.

Follow-up Items:

21. Mr. Hague stated that the staff would try to prepare papers for further discussion in February. Mr. Bossio suggested that the next step would likely be a meeting with advisors or some other subset of Board members.

General Announcements:

None