

Board Meeting Handout
Conceptual Framework—Elements
June 2, 2021

Meeting Purpose

1. The Board will discuss the definition of a liability. Specifically, the Board will address the following issues:
 - (a) Removal of the terms *probable* and *future* and the phrase *past transactions or events*
 - (b) Distinguishing between liabilities and equity
 - (c) Business risks, constructive obligations, and stand-ready obligations.
2. The Board also will discuss whether the term *control* should be included in the definition of an asset.

Questions for the Board

Definition of a Liability

1. Does the Board agree with the staff recommendation to remove the terms *probable* and *future* and the phrase *past transactions or events* from the definition of a liability?
2. Does the Board want to reaffirm its decision that an obligation that requires an entity to transfer or otherwise provide economic benefits to others should meet the definition of a liability?
3. Does the Board agree with the staff recommendations on distinguishing between liabilities and equity?
4. Does the Board want to add more explanatory language around whether executory contracts give rise to a present obligation?
5. Does the Board want to add language on economic compulsion?
6. Does the Board agree with the staff's recommended changes to the discussion on constructive and equitable obligations?
7. Does the Board want to add further clarification around stand-ready obligations? If so, what would the clarification(s) be?

Use of the Term *Control*

8. Should the term *control* be included in the definition of an asset?

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

9. If the Board chooses to not include the term *control* in the definition of an asset, are the proposed drafting changes appropriate?

10. If the Board chooses to include the term *control* in the definition of an asset, are the proposed drafting changes appropriate? What suggestions does the Board have for language to include in the basis for conclusions in proposed Chapter 4, *Elements of Financial Statements*, of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*?

Proposed Definition of a Liability

3. Proposed FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*—Chapter 4, *Elements of Financial Statements*, defines a liability as follows:

E37. A liability is a present obligation of an entity to transfer an economic benefit.

4. The explanatory paragraph in proposed Chapter 4 states the following:

E38. A liability has the following two essential characteristics:

- a. It is a present obligation.
- b. The obligation requires an entity to transfer or otherwise provide economic benefits to others.¹¹

¹¹This chapter continues the practice of describing liabilities as either an obligation to transfer or to provide economic benefits. For example, the term *transfer* has typically been used to describe obligations to pay cash or convey assets, and the term *provide* has typically been used to describe obligations to perform services or stand ready to do so.

Topic 1: Removal of the Terms *Probable* and *Future* and the Phrase *Past Transactions or Events*

5. Although the majority of respondents to the proposed chapter supported the Board's efforts to improve the concepts for elements, many disagreed with the Board's decision to remove the term *probable* from the definition of a liability. Likewise, there were some respondents with concerns about removing the term *future* and the phrase *past transactions or events*.
6. The majority of respondents did not support the removal of the terms and phrase from the definition of a liability for the following reasons:
- (a) Many respondents asserted that the term *probable* implies a necessary threshold of likelihood that is used in evaluating which items qualify as a liability.
 - (b) The term *future* is linked to the term *probable* regarding the likelihood of a future economic benefit.

- (c) Some respondents suggested that the phrase *past transactions or events* enhances the clarity of determining when an obligation becomes present and assists in distinguishing risks from actual liabilities.

Topic 2: Distinguishing between Liabilities and Equity

- 7. The majority of respondents to the proposed chapter supported the Board's decision on the concept to distinguish liabilities from equity. Many of the comments received centered around the following:
 - (a) Multiple respondents commented that additional clarifications are needed in describing when obligations to deliver an entity's own shares meet the proposed definition of a liability.
 - (b) Some responded that the Board should provide explanatory examples to help illustrate the concept of distinguishing between liabilities and equity.
 - (c) Some responded that the Board needs to clarify if and why an obligation to transfer a variable number of shares is a liability.

Topic 3: Business Risks, Constructive Obligations, and Stand-Ready Obligations

- 8. The issues related to business risks, constructive obligations, and stand-ready obligations are as follows:
 - (a) Business risks, specifically on executory contracts and economic compulsion
 - (b) Constructive obligations, specifically, more detailed explanatory language, distinction from legal obligations, and the discussion on equitable obligations
 - (c) Stand-ready obligations, specifically, determining when a contract represents a stand-ready obligation.
- 9. Comment letter respondents provided the following feedback on the above issues:
 - (a) Business risks: Multiple respondents indicated that it is unclear whether executory contracts give rise to a present obligation and questioned whether economic compulsion would create a liability.
 - (b) Constructive obligations: Some respondents requested additional clarification surrounding constructive obligations because of current diversity in practice, and others

suggested that the distinction between equitable obligations and constructive obligations was not helpful.

- (c) Stand-ready obligations: One respondent asserted that the discussion on stand-ready obligations was incomplete because it did not address those that were service related, and another respondent suggested providing more clarity in determining when a contract represents a stand-ready obligation.

Topic 4: Use of *Control* in the Proposed Definition of an Asset

10. At the April 21, 2021 Board meeting, the Board met to discuss the feedback from comment letter respondents on issues about the asset definition in proposed Chapter 4. At that meeting, the Board directed the staff to draft two alternatives of the asset definition, one including the term *control* and one without, along with potential explanatory language on the issue.