FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting—Chapter 4, Elements of Financial Statements
Issues Paper

Objective

1 The objective of this paper is to provide an overview of the changes suggested in the Financial Accounting Standards Board's (FASB's) Exposure Draft *Concepts Statement No. 8, Conceptual Framework for Financial Reporting, Chapter 4: Elements of Financial Statements* and to receive any comments from EFRAG TEG and EFRAG CFSS members on this.

The FASB's Exposure Draft

2 The FASB issued the exposure draft *Concepts Statement No. 8, Conceptual Framework for Financial Reporting, Chapter 4: Elements of Financial Statements* ('the ED') on 16 July, 2020. The chapter defines 10 elements of financial statements: assets, liabilities, equity (net assets), revenues, expenses, gains, losses, investments by owners, distributions to owners, and comprehensive income. This proposed chapter is intended to replace Concepts Statement 6, *Elements of Financial Statements*. Comments are requested by November 13, 2020.

3 The ED clarifies the elements definitions in Concepts Statement 6 by:

(a) Clearly identifying the right or obligation that gives rise to an asset or a liability

(b) Eliminating terminology that makes the definitions of assets and liabilities difficult to understand and apply

(c) Clarifying the distinction between liabilities and equity and between revenues and gains and expenses and losses

(d) Modifying the distinctions in equity for not-for-profit entities.

4 The FASB's Conceptual Framework has a similar status as the IASB's Conceptual Framework. That is, the FASB uses its Conceptual Framework (Concept Statements) when developing standards. The FASB's Concept Statements are not authoritative. Some of FASB's standards are inconsistent with the Concept Statements. The Concepts Statements do not override authoritative standards. If accounting for a transaction or event is not specified in authoritative generally accepted accounting principles (GAAP), an entity first must consider accounting principles for similar transactions or events within authoritative GAAP and then consider nonauthoritative guidance from other sources (including Concepts Statements).

5 The ED is not part of a convergence project with the IASB. The ED may, indirectly, influence how similar US GAAP will be with IFRS, as the FASB will use its Concepts Statements when developing standards.

6 In March 2018, the IASB issued its revised Conceptual Framework for Financial Reporting. The IASB's new Conceptual Framework included revisions of the definitions of elements of the financial statements (e.g. assets and liabilities).

7 Neither the IASB nor the FASB expects that their revised definitions of an asset will have any significant implications for what is recognised as an asset. The changes to these definitions could accordingly not be expected to decrease or increase the similarity between US GAAP and IFRS Standards in the future. The revised definition (and supporting guidance) of a liability in the IASB's Conceptual Framework, would result in some obligations meeting the definition of a liability earlier than under the current requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The FASB's ED does not include similar guidance but does also not guidance that would seem to conflict with the guidance in the IASB's revised Conceptual Framework on this issue.

8 The proposed guidance in the FASB's ED on the distinction between liabilities and equity (see paragraphs 18–20 below) may be considered closer to the requirements included in IAS 32 *Financial Instruments: Presentation* than the current guidance in the FASB's Concept Statements. However, as US GAAP is inconsistent with the current guidance in the FASB's Concept Statements, it cannot be concluded that the distinction between debt and equity would likely be more similar in US GAAP and in IFRS Standards as a result of the suggested guidance in the FASB's ED.

9 The paragraphs below summarise the FASB's ED on the issues mentioned in paragraphs 3(a)–3(c) above.

Assets

10 Currently, the FASB defines assets as follows:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

11 The ED proposes the following new definition:

> An asset is a present right of the entity to an economic benefit.

12 The proposed new definition addresses the following issues identified by the FASB in relation to the current definition:

(a) The term 'probable' in the current definition has been misunderstood as implying that a future economic benefit or a future sacrifice of economic benefit must be probable to a certain threshold before the definition of an asset is met. Accordingly, the FASB suggests eliminating that term from the proposed definition. Before the latest revision of the IASB's Conceptual Framework, the definition of an asset also included the term 'probable'. This reference was removed as the IASB had identified similar issues as the FASB[1].

(b) The term 'future' in the current definition results in the misunderstanding that the asset is the ultimate future inflow. For example, in the instance of trade receivables, the definition could be misunderstood to indicate that the asset is the successful collection of the receivable in the future instead of the present right to collection. Accordingly, the ED proposes to refer to a present right to demonstrate that an asset exists. The term 'future' also existed in the IASB's definition of an asset before the latest revision of the IASB's Conceptual Framework. The reference was removed from the definition for the same reasons as stated in the FASB's ED. However, in the IASB's Conceptual Framework the reference now appears in the supporting definition of an economic resource (the FASB' ED does not use the term 'economic resource'

[1] The Appendix includes the definitions of the IASB's Conceptual Framework for Financial Reporting.

as some of the FASB's constituents interpreted it as being limited to physical resources).

(c) The term 'control' in the current definition is sometimes improperly viewed as control of a probable future economic benefit in the same manner as for business combinations or consolidation accounting. Additionally, in applying the term 'control', some often fail to properly identify what is controlled under the asset definition. For example, in the instance of trade receivables, the definition could be misunderstood to indicate that what is controlled is the successful collection of the receivable in the future instead of the present right to collection. Although the notion of control is important, the ED expresses the view that 'a present right' to an economic benefit would seem to be sufficient to establish the fact that an asset is an asset of a particular entity. The IASB's definition of an asset includes the term 'control' and the IASB's Conceptual Framework includes guidance on how the term should be interpreted.

(d) The current definition refers to 'past transactions or events'. The FASB concluded that if an entity has a present right or a present obligation, one can reasonably assume that it was obtained from some past transaction or event. Therefore, that phrase is considered redundant and has been eliminated from the proposed definitions. The IASB's definition of an asset (and of a liability) refers to 'past events'. When revising the definitions, the IASB did not identify any significant problems that had arisen from including the phrase. The IASB found the reference particularly important to the revised definition of a liability[2]. In relation to assets, identifying the past event, is, in the view of the IASB, used when determining how to report an event in the financial statements. For example, how to classify and present income, expenses or cash flows arising from that event.

13 The FASB expects that most assets that meet the current definition of an asset, will continue to qualify as assets under the definition of an asset in the ED. The FASB is interested in learning whether the proposed definition is helpful in resolving issues of identifying intangible assets.

Liabilities

14 Currently, the FASB defines a liability as follows:

> 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.

15 The ED proposes the following new definition:

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

16 The proposed new definition addresses the issues in relation to the terms 'probable', 'future' and 'past transaction or event' listed above in paragraph 12 in relation to assets. In addition, the ED clarifies when an entity becomes presently obligated (see paragraph 17 below), and fundamentally expands the population of liabilities to include present obligations settled with an entity's own shares rather than exclusively with assets (see paragraphs 18–20 below).

17 The ED thus includes new guidance on, for example, business risks, constructive obligations, and stand-ready obligations.

---

[2] In relation to the definition of a liability, the IASB notes that 'as a result of past events' means that: (a) an entity has obtained economic benefits or taken and action (b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. The activity increases the magnitude of the economic resources that the entity will or may have to transfer.

18 Under the current definition a present obligation requires the transfer of assets of an entity or the provision of services to other entities. Under the current definition, obligations that require future transfers of equity instruments of the entity are thus not liabilities. Current US GAAP is inconsistent with this. The proposed definition does not refer to the transfer of assets or the provision of services. Instead it refers to an 'economic benefit'. It is specified in the ED that:

> A transfer of shares sufficient in number to satisfy an obligation of determinable or defined amount is a transfer of an economic benefit. If arrangements permit or require settlement of obligations by issuance of a variable number of the entity's own shares, those shares are essentially being used in lieu of assets to settle an obligation and therefore meet the definition of a liability.

19 The ED thus expands the population of liabilities that were included under the previous definition of a liability to include certain obligations to issue or potentially issue an entity's own shares.

20 Under the ED an obligation to transfer a fixed number of own shares is not considered a liability. The ED states that:

> [T]he holder of such an instrument, although not currently a shareholder of the entity, is on the path to potentially becoming a shareholder of the entity. Holders of that type of instrument participate in the risks and rewards of the issuer's operations, just not the same way in which a counterparty of an outstanding share does. For example, a holder of a written call option participates in the upside potential in the same way a common shareholder does. That holder also participates in a downside risk, that is, the loss of the premium paid for the instrument. The Board notes that an obligation that requires the issuance of a sufficient number of shares to equal a specific value when issued is a liability. The value to the recipient is fixed; as such, the obligation conveys nothing like the returns and rewards of an equity shareholder.

Revenue, expenses, gains and losses

21 Currently, the FASB defines revenue, expenses gains and losses as:

> Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.
>
> Gains are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.
>
> Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.
>
> Losses are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.

22 The ED proposes these definitions:

> Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities.
>
> Gains are increases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.
>
> Expenses are outflows or other using up of assets of an entity or incurrences of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities.
>
> Losses are decreases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.

23 As it appears "that constitutes the entity's ongoing major or central operations" is suggested removed from the definitions of revenue and expense. The FASB considered that it is currently not clear whether the term 'ongoing major or central operations' is intended to refer to all revenues and expenses or only those that relate to revenues and expenses from other activities. As a result, the FASB decided to propose removing the term ongoing major or central operations from the proposed definitions of revenue and expense.

24 From the definitions of gains and losses 'peripheral or incidental' is suggested removed as gains and losses may not be peripheral or incidental transactions to many entities.

25 The IASB's Conceptual Framework for Financial Reporting does not define revenue, gains and losses. It only defines income and expenses based on the changes in assets and liabilities.

26 Before the latest revision, the IASB's Conceptual Framework stated that income includes revenue and gains and that expenses include losses. However, the latest revision of the Conceptual Framework reflects that the IASB considers that it is unhelpful to have the Conceptual Framework defining subclasses of income and expenses.

Questions for EFRAG TEG/CFSS

27 What are the comments of EFRAG TEG/CFSS on the changes suggested in the FASB's ED? (Comments could include views on the issues where the IASB and the FASB have taken different approaches (e.g. in relation to 'control'; 'past events'; the guidance on when an obligation to transfer own shares is a liability; and the definitions of revenue, expenses, gains and losses)).

Appendix: Definitions included in the IASB's Conceptual Framework for Financial Reporting

Introduction

An asset

A present economic resource controlled by the entity as a result of past events.

An economic resource is a right that has the potential to produce economic benefits.

A liability

A present obligation of the entity to transfer an economic resource as a result of past events.

The Conceptual Framework for Financial Reporting explains that an obligation is a duty or responsibility that the entity has no practical ability to avoid.

Income and expenses

Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.