

MINUTES



To: Board Members
From: Prince (x229)
Subject: Minutes of the June 25, 2008 Board Meeting: Elements and Recognition: Phase B **Date:** July 7, 2008
cc: Leisenring, Bielstein, Golden, MacDonald, Allen, Posta, Glotzer, Klimek, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton, Hickey, Clark, Crook, Lian, Hague, Villmann, Willis, GASB: Reese, Patton

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, Interpretation, or FSP.

Topic: Definition of a Liability: Laws, Statutes, and Regulations and Dealing with Uncertainty

Basis for Discussion: Memorandums 74A—74D, dated June 3, 2008

Length of Discussion: 9:00 to 10:05 a.m.

Attendance:

Board members present:	Herz, Batavick, Linsmeier, Seidman, Smith, and Young
Board members absent:	Crooch
Staff in charge of topic:	Villmann
Other staff at Board table:	Hague, T. Johnson, Lott, and Prince
Outside participants:	Lian and Bunting (IASB, by phone)

Summary of Decisions Reached:

As part of its joint project with the IASB, the Board considered how to determine when statutes, laws, and regulations give rise to a liability and how to deal with uncertainty when ascertaining the existence of a liability.

Statutes, laws, and regulations

The Board noted that an entity may be subject to the requirements of a statute, law, or regulation, yet a government or other party cannot enforce those requirements until the entity violates the statute, law, or regulation or until an event occurs that triggers the requirements. The Board discussed three examples—an environmental obligation, a statutory warranty, and a speeding ticket—and decided the following:

1. An entity does **not** have a present unconditional obligation to comply with a statute that is not yet effective.
2. An entity does **not** have a present unconditional obligation for future actions it expects or intends to take but cannot be compelled to take.
3. An entity does **not** have a present unconditional obligation to transfer economic resources merely because it must comply with the law. An obligating event must also have occurred.
4. An entity has a present unconditional obligation at the reporting date when the entity violates a requirement or when another obligating event has occurred.
5. An entity has a present unconditional obligation that has an associated conditional obligation (a stand-ready obligation) when a statute requires the entity to provide risk protection. That requirement results in an implicit contractual obligation between the two parties.
6. An entity has a present unconditional obligation that has an associated conditional obligation when the entity separately agrees to bear another's risk that arises from being subject to a statute.

Dealing with uncertainties

Uncertainties result from situations where evidence is lacking or facts are unclear. The Board considered whether to address uncertainties about whether a liability exists in the

guidance accompanying the definition or in the criteria for recognition. The Board decided to address uncertainty in the guidance accompanying the definition. The Board decided that if an entity is uncertain about whether a liability exists, that entity should make a neutral judgment based on its understanding of the facts and circumstances at the end of the reporting period. If it is judged that a liability exists, uncertainty about the amount of the liability would be taken into account in measurement. The Board also decided that additional guidance should be developed on how those judgments can be made in a comparable manner at a standards level.

The Board considered additional situations to evaluate the robustness of the working definition of a liability. With regard to the proposed working definition of a liability, the Board directed the staff to consider revising the definition (1) to include an additional reference that an economic obligation must be unconditional and (2) to replace the description that an economic obligation is something that is capable of resulting in “cash outflows or reduced cash inflows, directly or indirectly” with “provision of an economic resource.” Also, the Board agreed with the summary of tentative decisions made to date and its proposed working definition, including the suggested revisions above, as a basis for drafting those aspects of the discussion paper on elements and recognition.

The IASB discussed these issues and proposals about the proposed working definition of a liability and reached similar conclusions at its meeting on June 20, 2008.

Objective of Meeting:

The objective of this meeting was to have the Board discuss two issues on the definition of a liability that is being developed in Phase B (Elements & Recognition) of the joint conceptual framework project. Those two issues are (1) determining when statutes, laws, and regulations give rise to a liability and (2) dealing with uncertainty when ascertaining the existence of a liability. The objective also entailed having the Board affirm past decisions made on the working definition of a liability and approve the working definition itself so that the staff could begin drafting these aspects of the discussion paper. The objective was met.

Matters Discussed and Decisions Reached:

ISSUE 1—STATUTES, LAWS, AND REGULATIONS

Staff Remarks

1. Ms. Villmann stated that statutes set the requirements to which an entity is subject; however, until a stipulated event or violation of the statute has occurred, the entity cannot be forced to do anything nor does the entity have an unconditional obligation that is enforceable against the entity. She noted that the staff memo examines this principle using three examples—an environmental obligation, a statutory warranty, and a speeding ticket.
2. Ms. Villmann asked the Board members whether they agreed with the staff’s conclusions as to when statutes, laws, and regulations do and do not give rise to an unconditional obligation.

Board Vote

3. The Board unanimously agreed with the staff’s conclusions, which were as follows:
 - An entity does **not** have a present unconditional obligation to comply with a statute that is not yet effective.
 - An entity does **not** have a present unconditional obligation for future actions it expects or intends to take but cannot be compelled to take.
 - An entity does **not** have a present unconditional obligation to transfer economic resources merely because it must comply with the law. An obligating event must also have occurred.
 - An entity has a present unconditional obligation at the reporting date when the entity violates a requirement or when another obligating event has occurred.
 - An entity has a present unconditional obligation that has an associated conditional obligation (a stand-ready obligation) when a statute requires the entity to provide risk protection. That requirement results in an implicit contractual obligation between the two parties.
 - An entity has a present unconditional obligation that has an associated conditional obligation when the entity separately agrees to bear another’s risk that arises from being subject to a statute.

Board Comments

4. Ms. Seidman commented that the second part of the speeding ticket example is a distraction to the overall analysis because the company's indemnification of its drivers is an example of a contract, and not an example of how statutes may give rise to a liability.
5. Mr. Linsmeier commented that the staff should communicate clearly in its discussion paper on elements and recognition the distinction between general business risks and conditional obligations. That distinction is important because it assists preparers of financial statements in determining when a conditional obligation exists and, therefore, when they need to look for a potentially associated unconditional obligation. Mr. Linsmeier noted that it would be helpful to communicate how preparers should view the existence of a statute prior to the existence of an unconditional obligation—as a conditional obligation or as a general business risk. He expressed his concern that the discussion paper needs to be clear whether the search for potentially associated unconditional obligations needs to be performed for scenarios involving laws, statutes, and regulations as well as for contractual scenarios.
6. Mr. Johnson noted that there may be a distinction that could be drawn on how to analyze a scenario depending on whether the context is a contractual or a statutory scenario.
7. Mr. Linsmeier noted that it may be much easier to focus on identifying an unconditional obligation rather than focusing on identifying a conditional obligation and then seeking out the associated unconditional obligation. He expressed concern about creating a model that would be cumbersome to apply.
8. Mr. Batavick commented that the staff's recommended judgmental approach for dealing with uncertainty about the existence of a liability would come into play when analyzing the environmental obligation example.
9. Mr. Linsmeier commented that he did not see much difference between an unconditional obligation (that has an associated conditional obligation) that arises when a statute requires an entity to provide risk protection and an unconditional obligation (that has an associated conditional obligation) that arises if the entity

agrees to bear another's risk of being subject to a statute. Ms. Seidman agreed with Mr. Linsmeier.

ISSUE 2—DEALING WITH UNCERTAINTY

Staff Remarks—Location of Guidance

10. Ms. Villmann stated that, at times, there may be uncertainty as to whether the definition of a liability has been met. She noted that the staff is recommending that a discussion on how to address uncertainty be located in the accompanying guidance to the proposed definition of a liability to enable the conceptual definition to be applied in a practical matter.

Board Vote

11. The Board unanimously agreed that uncertainty be dealt with in the accompanying guidance to the definition of a liability.

Staff Remarks—Addressing Uncertainty

12. Ms. Villmann noted that uncertainty results from situations where evidence is lacking or facts are unclear. To deal with uncertainties, the staff recommends that the accompanying guidance to the definition of a liability require that the definition be applied by judging whether a liability exists on the basis of the facts and circumstances at the end of the reporting period. The staff also recommends that this judgmental approach should be applied neutrally when ascertaining the existence of any element of the financial reports when there are uncertainties and that additional guidance should be developed on how these judgments can be made in a comparable manner at a standards level.

Board Vote

13. The Board unanimously agreed that that if an entity is uncertain about whether a liability exists, that entity should make a neutral judgment based on its understanding of the facts and circumstances at the end of the reporting period. The Board also decided that additional guidance should be developed on how those judgments can be made in a comparable manner at a standards level.

Board Comments

14. Ms. Seidman asked the staff whether the discussion paper would touch on the strict and lenient approaches mentioned in the staff’s memo. Mr. Hague noted that it probably would. Ms. Seidman commented that she thinks both the strict approach and the lenient approach are not neutral. (The staff memo had highlighted only the strict approach as not being neutral.)

ISSUE 3—PROPOSED WORKING DEFINITION

Staff Remarks—Affirmation of Tentative Decisions

15. Ms. Villmann asked the Board members whether they agreed with the decisions that had been made to date on the proposed working definition of a liability.

Board Vote

16. The Board unanimously affirmed its decisions.

Staff Remarks—Approval of Definition

17. Ms. Villmann commented that members of both the IASB and the FASB have provided the staff with suggestions on how the working definition of a liability could be revised. These revisions include (a) adding the reference that an economic obligation must be unconditional and (b) replacing the description that an economic obligation is something that is capable of resulting in “cash outflows or reduced cash inflows, directly or indirectly” with the “provision of an economic resource.” Ms. Villmann noted that the latter revision would simplify the wording, not change the meaning. She asked the Board members whether they supported the proposed definition of a liability, taking into consideration the proposed revisions, as a basis for drafting the discussion paper.

Board Vote

18. The Board unanimously agreed with the proposed working definition, including the suggested revisions above, as a basis for staff to begin drafting those aspects of the discussion paper on elements and recognition.

Board Comments

19. Mr. Linsmeier asked whether the IASB had considered substituting the mention of cash flows with mention of an asset, rather than an economic resource. Ms. Villmann noted that the staff’s concern about using “asset” is that it would (a) require an entity

to meet the definition of an asset to have a liability and (b) take the focus off the present obligation and place it on the outflow. Mr. Linsmeier stated that this change will assist the Board later on when addressing the issue of defining the line between liabilities and equity. Mr. Linsmeier noted that it might be necessary to specify that what is provided is an economic resource “of the entity,” to be clear that a liability does not arise from a capability of providing someone else’s economic resource.

20. Mr. Herz commented that including a reference to unconditional in the definition of a liability would, in a situation where a company has promised employees certain benefits after a specified vesting period, result in no liability existing until the employees had vested, assuming nothing could be enforced against the company if the company terminated its employees prior to vesting. Mr. Batavick noted a potential alleviation to that conclusion would be to require additional disclosures.
21. Mr. Linsmeier questioned how Mr. Herz’s employee benefit example would differ from an example of a financial guarantee because both examples seem to be contractual arrangements. Mr. Lott stated that in the case of the guarantee, the guarantor has no ability to get out of the contract without some sort of payment. However, in the case of the employee benefits, the employer does have some ability to get out of its agreement with its employees.
22. Mr. Herz questioned whether the current measurement model for obligations that are unavoidable is preferable to how measurement under the proposed working definition would work.
23. Mr. Smith commented that if Board members are feeling uncomfortable with the answers that the proposed definition is providing then there may be something wrong with the proposed definition.
24. Mr. Herz stated that the model for addressing uncertainty recommended by the staff—the judgmental approach—may serve as a safety net when applying the definition of a liability. Mr. Batavick agreed. He believes that in situations where there is uncertainty about whether an obligation is unconditional, judgment should be applied to determine whether the obligation is unconditional.
25. Mr. Lott commented that the key question in the employee benefits example is whether the employees can enforce something against the employer. Mr. Smith noted

that in the environmental obligation example, no liability would be recognized until the entity had emitted carbon dioxide in excess of the specified limit, which he believes is inappropriate.

26. Mr. Linsmeier commented that the staff's analysis seems to conclude that an entity with the ability to opt out of an obligation does not have a liability. Mr. Lott noted that the key question is whether something can be enforced against the entity. Mr. Herz agreed with Mr. Lott. Mr. Linsmeier noted that applying judgment to the uncertainty surrounding the enforceability of the employer's promise in the employee benefits example may lead the employer to conclude that a present unconditional obligation exists prior to the vesting date.
27. Mr. Young commented that he thinks the fundamental question is whether specific business risks should be recognized. He questioned whether the proposed definition of a liability would be appropriate for forecasting future cash flows.
28. Mr. Herz commented that the discussion paper should include enough examples to help readers understand the concepts. Mr. Hague agreed.
29. Mr. Young asked Ms. Villmann to explain the reason for the proposed revision of replacing the description that an economic obligation is something that is capable of resulting in "cash outflows or reduced cash inflows, directly or indirectly" with "provision of an economic resource." Ms. Villmann explained that the revision would simplify the words used in the definition because the definition of "economic resource" refers to cash. An economic resource is defined in the asset definition as "something that is scarce and is capable of producing cash inflows or reduced cash outflows, directly or indirectly, alone or together with other economic resources."
30. Mr. Linsmeier noted that the proposed change was probably meant to include in the definition of a liability those obligations that are fulfilled in something other than cash.
31. Mr. Herz commented that "provision of an economic resource" seems to denote only a potential outflow, rather than a potential reduction in inflows.
32. Ms. Seidman noted that she would prefer that the proposed definition's accompanying text simply refer to the fact that obligations are enforceable against an entity, rather than discussing a link to the entity.

Follow-Up Items:

None.

General Announcements:

None.