

# Symmetric Prudence in New Definitions of Conceptual Framework for Financial Reporting

Shkulipa Liudmyla

National Academy of Statistics, Accounting and Audit: Kyiv, Kyiv, Ukraine

Received 25 November 2020

Accepted 5 January 2021

## ABSTRACT

*Since the version of the Conceptual Framework for Financial Reporting is revised, the interest in accounting concepts that are fundamental in financial reporting has been growing. The purpose of this article is to investigate the evolutionary logic of prudence in the definitions and recognition criteria of assets and liabilities, the causes and consequences of new changes in the Conceptual Framework of 2018. As a result, it was obtained that different interpretations of probability and asymmetric asset and liability identification caused the new changes. The reconciliation between the intentions of new asset and liabilities definitions and their correct understanding results has been illustrated. The new complication in defining obligation such as “no practical ability to avoid” was found. In conclusion, we constant the new definitions as the positive consequence from a psychological point of view, simplifying individuals judgments, as from a conceptual point of view, leading to the common understanding and improvements of qualitative characteristics of financial information. The direct evidence of conceptual improvement is symmetric prudence as support of financial statements’ fundamental qualitative characteristics – faithful representation.*

**Keywords:** Asset, Liability, Probability, Conceptual Framework for Financial Reporting, Prudence

## Introduction

The Conceptual Framework of Financial Reporting is the necessary foundation for all IFRS accounting philosophy to be built and an integral part of standards. In the case of professional judgment needs when there is no direct guidance in the standards, the users should be contacted the Conceptual Framework. Therefore, for those accountants seeking to improve their IFRS skills and knowledge, understanding the Conceptual Framework’s context is

\*Corresponding author. E-mail address: [job.shkulipa@gmail.com](mailto:job.shkulipa@gmail.com)

Doi: 10.32038/NCAF.2021.05.03

essential. Besides, the Conceptual Framework for Financial Reporting is an essential foundation for learning about financial reporting (Kieso et al., 2016).

Even though the Conceptual Framework is a necessary but not sufficient part of IFRS Standards, auditors still mention concepts in those settings where the accounting handling is unclear (Deloitte, 2016). Lawyers also trust the conceptual frameworks when filing complaints against firms for supposed inappropriate accounting (e.g., State Treasurer of Michigan v. AIG, 2008; Public Employees Retirement Association of Colorado and General Trading of Philadelphia v. Royal Ahold N.V. Securities & ERISA, 2004; Cosmos Investment v. Bally Total Fitness Holding Corporation, 2004).

This research focuses on the Conceptual Framework of Financial Reporting that has been revised in March 2018. We have investigated all new changes of this critical normative document that is the main background of all accounting concepts as financial reporting is the final stage of accounting. After researching, it was found a sufficient difference between the revised and previous Conceptual Frameworks. The found difference is connected with the main context involving fundamental concepts in accounting and reporting and the size of this document. Specifically, the structure of the current document contains corresponding 320 paragraphs, split into eight chapters. In comparison, the Conceptual Framework of 1989 consisted of 105 paragraphs in total without chapters; the Conceptual Framework of 2010 had 125 paragraphs split into four chapters.

It should also be noted that the Conceptual Framework of 2010 was a result of the joint project between the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to have a common basis for the existing IFRS and GAAP accounting concepts. These two leading financial reporting systems wish to harmonise accounting rules for resolving financial reporting controversies. However, on 28 September 2010, both boards issued the incomplete version of the Conceptual Framework for Financial Reporting due to the lack of resources for faster completion of the Project and the changed priorities that slowed progress. Therefore, in 2011 the International Accounting Standards Board (IASB) planned to revise the Conceptual Framework as a new comprehensive IASB-project after the discussion of major gaps of this document: the reporting entity; presentation and disclosure; asymmetry in treating gains and losses; definitions of equity and supporting discussion; materiality (IASPlus, 2018).

At the IASB Research Forum 2016 – the scholar conference organised by the IFRS Foundation and the journal Contemporary Accounting Research – Mary Tokar mentioned that the Conceptual Framework is very useful, this is the highest praise possible (Tokar, 2016). According to the development complications, the IASB tried to catch a balance between providing high-level concepts and reaching the same understanding from users of this document (note that in this research the users of the Conceptual Framework means by us the individuals who prepare the financial reporting that differ from users of financial reporting). For example, the previous Conceptual Frameworks sought to explain that expected (by IASB) and probable (by FASB) cash flows or another economic resource were included solely to emphasise that economic activity occurs in an uncertain environment and not to recognise the existence of an asset and liability if the transfer of future economic benefits with high probability occurs (FASB, 2007). It is noted that both standard-setting boards explained probability differently – the IASB uses the word *expected*, and the FASB uses the word

*probable* (Cade et al., 2019). However, setters' attempts to clarify it to practitioners have largely proved ineffective, evidenced by the open discussion of the Draft Conceptual Framework for Financial Reporting in 2015 (IASB, 2015).

So, as probability and expectations were in the asset and liability accounting, in this article, we aim to observe the evolutionary logic of assets and liabilities definitions under the influence of revisions in the Conceptual Framework of Financial Reporting, reasons and consequences of them in a consistent understanding by concept-setters and practitioners. According to the aim of this article, the following points have been set: 1) to investigate the evolutionary changes in asset and liabilities definitions in the Conceptual Framework and the causes that led to these changes; 2) examine the understanding of the probability threshold before and after changes in asset and liability definitions; 3) find out the consequences of these changes for a consistent understanding between setters and practitioners. If concepts of standard setters about assets or liabilities differ from those who use the conceptual framework, then a necessary step in determining such improvements is understanding these revisions.

### **Literature review**

As the Conceptual Framework for Financial Reporting is an important foundation for learning about financial reporting by Kieso, Weygandt, and Warfield (2016), assets and liabilities are two of the most fundamental financial reporting elements (Storey & Storey, 1998). In the accounting literature, some studies focus either on recognition or the existence of an asset or a liability. Under the changes in the Conceptual Framework in the definitions of an asset and a liability and the revision of its recognition criteria, we should find the main distinctive characteristic between the new and old definitions of assets and liabilities on the conceptual level and find out the reason that led to these changes. Because the loss of understanding of the standard-setters original intent emphasises the importance of a sufficient basis for conclusions for the work of the IASB, to help all using IFRS to understand the background in which the Board members intended the standards to be applied (Tokar, 2016).

Among the literature devoted to the existence of assets and liabilities, Jiambalvo and Wilner (1985) stand out as pioneers. In their paper, the authors focus on disclosing versus recognising (i.e., making a journal entry for) a contingent liability. They research the role of probability in financial reporting that addresses understanding it in the context of contingent liabilities differentially (e.g., Jiambalvo & Wilner, 1985). Documenting the journal entry accountants treat assets and liabilities asymmetrically (Basu 1997; Watts 2003a,b). This asset-liability asymmetry result was set without incentives or other conditions favouring conservatism and with a group of participants who arguably have no predisposition to display this tendency.

The use of probability in decisions about the existence of assets and liabilities has been examined by scientists Botosan, Koonce, Ryan, Stone, and Wahlen (Botosan et al., 2005). Arkes (1991) studies timely and scholarly insights into how individuals judge the existence of assets and liabilities. Therefore, we agree that settling the existence of assets and liabilities either by requiring certainty or some high probability threshold is hard, making it difficult to change (Arkes, 1991). Indeed, the original formulation of the FASB's definitions did not have the word *probable*, but later it was added as a response to various comments expressing

concern that assets would only be thought to exist if a future benefit was certain (Storey & Storey, 1998). Logically, individuals tend to favour certainty (Kahneman & Tversky, 1979; Slovic et al., 1982). It is easier for individuals to think about situations involving certainty than about situations involving uncertainty (Dickhaut et al., 2013).

The prior literature (Aharony and Dotan 2004; Amer et al., 1994; Harrison and Tomassini, 1989; Raghunandan et al., 1991) consists of auditors and preparers' influence on the numerical equivalents for various probability phrases. There is a negative side when American standard setters have firmly deviated from their conceptual definitions to achieve the desired accounting situation. Because the contingent liability setting is one of the few situations where the FASB intentionally requires a probability threshold for recognition, meaning that existence does not indicate recognition (FASB and IASB, 2007).

In contrast, the studies that focus on an asset or a liability (Cade et al., 2019) state that existence is a crucial determinant of recognition, with relevance, reliability, and measurability being the other determinants (FASB and IASB, 2007). Cade et al. (2019) examine how the type of financial statement item (asset versus liability) might be judged differently. Both boards (IASB and FASB) have reasoned that their definitions cause individuals to misuse probability as a factor of whether an asset or a liability occurs. Nevertheless, their intent was merely to emphasise that economic activity happens in an uncertain situation and not to recognise the existence of an asset and liability if the transfer of future economic benefits with high likelihood occurs (FASB and IASB, 2007). The problem comes up from the wrong natural thinking of people about assets and liabilities independent of these definitions (Konold, 1989). Is information that is not united with natural reasoning useful?

As an explanation about natural thinking is Rozin and Royzman (2001) investigations, Taylor (1991) that observe different judgments of assets and liabilities as consistent with psychology research. They suggest that individuals are more sensitive to negative (relative to positive) information and propose a natural preference for conservatism. One more research draws on psychology theory regarding how individuals deal with uncertainty (Kahneman and Tversky, 1982) to investigate whether people use probability in a way that deviates from standard setters' intentions determining if an asset or if liability exists. As a result, we agree with this research that individuals are not good at probabilistic reasoning (Bernstein, 1998) and, therefore, often simplify a given task to render the required judgment (Kahneman and Frederick, 2002). Their findings need to be highlighted in terms of two probable ways that psychology theory predicts that people will simplify probabilistic-reasoning tasks. Particularly, when standard-setters believed that individuals should use probability when judging the existence of assets and liabilities. Therefore, we have a minimum of one reason to determine that the new definitions of an asset and a liability have positive explanations from a psychological point of view.

All these facts lead us to state our central hypothesis as follows:

*H1: The revision of an asset and a liability definition, excluding probability, has led to a reduction in misunderstanding the setters' intend by practitioners.*

### **Research methodology**

According to sensitivity to variations in probability, how to judge the existence of assets or liabilities, as previous and now conjectured by standard setters, was tested by experiments

(see Libby et al., 2002; Cade et al., 2019). Despite the data used in 2016, we decided to use the exciting research made by Cade et al. (2019) regarding questions about an asset and a liability. As Bernard and Schipper (1994) mentioned, similar investigations are generally not possible with other research approaches. Therefore, in our mind, this investigation may help to find out *reasons* that led to definitions changes and determine the *consequences* associated with a potential change to the Conceptual Framework before changes to understand the Board's intentions better, thereby providing standard setters with timely feedback about their ideas for change. If concepts of standard setters of assets or liabilities differ from those who use the conceptual framework, it is then necessary to determine how to realise improvements in understanding this difference.

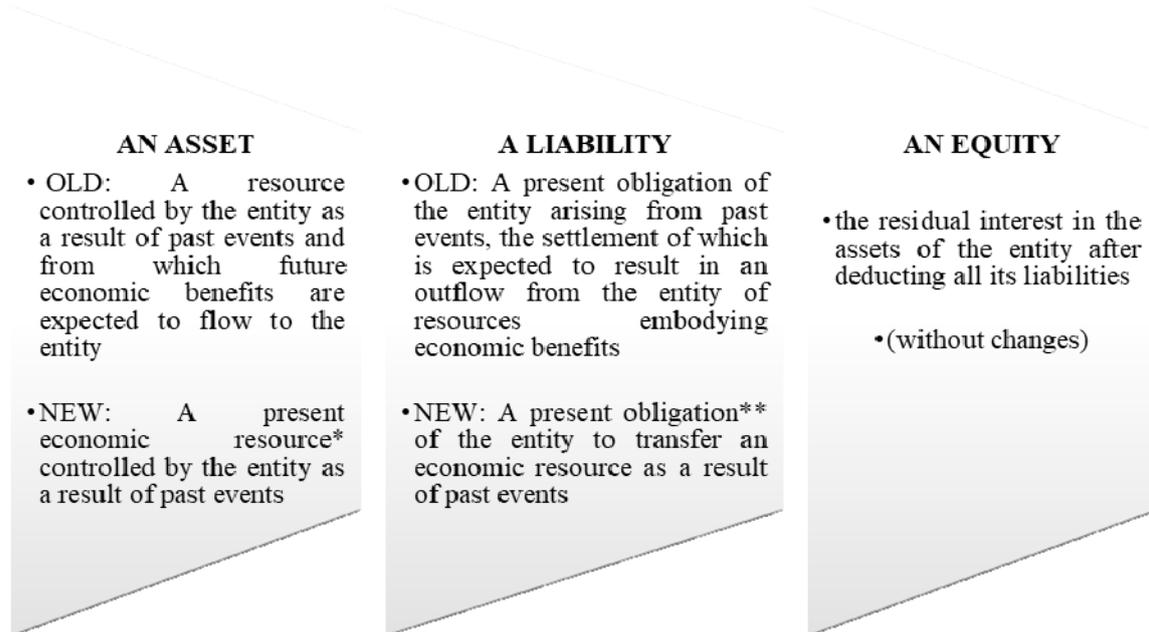
This article's research methodology involves the *interpretation* method based on the central issue of the experiments conducted by Cade et al. (2019). Mainly, in their research, the numerical probabilities regarding the probability of a future economic benefit (or a sacrifice of an economic benefit) are not available in most real situations. As that experiments made in 2016, before the revision of 2018, how their results influence a consistent understanding between setters and practitioners determining the current extent of successful realising improvements is the main direction of this research.

The study is *descriptive*. Its purpose is to describe the evolutionary changes in asset and liabilities definitions in the Conceptual Framework. For a thorough study, it was used as a *qualitative approach*. As qualitative research is especially useful for obtaining specific information about the opinions of specific groups of scientists, a qualitative approach aimed to understand this investigation topic from researchers' viewpoint in accounting. Thus, as bibliometrics is very useful for organising available knowledge within a specific scientific discipline (Merigo and Yang, 2017), in this study, it was necessary to research a *bibliometric analysis* that has been thoroughly disclosed in the previous section as a result of previous studies of scientists. The collected data was then analysed using an *interactive analysis method*, which was carried out interactively from one stage to another, consisting of data comparison, data display, and verification. To reduce the explanations and achieve better understanding by readers, the illustrative approach describes differences between intentions of setters and misinterpretations of practitioners the old asset and liabilities definitions, and the results of understanding after the revisions these definitions have been illustrated.

## Results

According to the first set of research objectives, we found the main distinctive characteristic between the new and old definitions of assets and liabilities on the conceptual level (see Figure 1, Figure 2) and determine the reason that led to these changes. Considering the Conceptual Frameworks of 1989, 2010, and 2018, the periods of its significant changes, the description of the asset and liability definition was always in the separate section of "The elements of financial statements". The document identified (till now) five elements of the financial statements, such as assets, liabilities, and equity, as related to the financial position of the entity (see Figure 1), as well as income and expenses related to the financial performance of the entity. As we mentioned above the Conceptual Framework of 2018 has undergone significant changes. The number of paragraphs in the section about the elements of financial statements has also been sufficiently changed, particularly: in 2018 – 72 paragraphs

versus 34 paragraphs in 2010 and the same number of paragraphs in 1989.



Note: \* An economic resource is a right that has the potential to produce economic benefits.

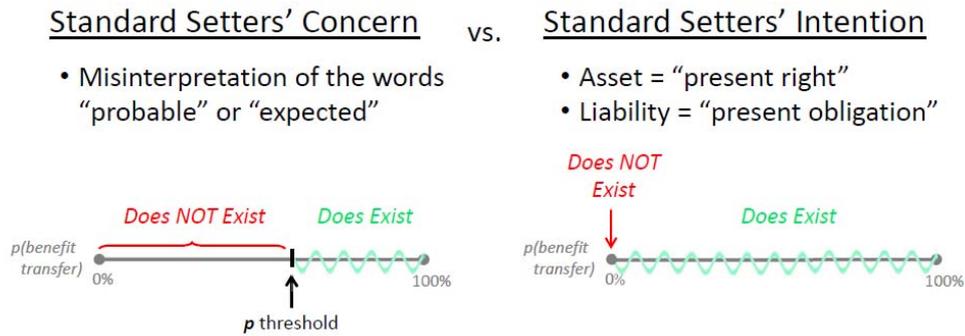
\*\*An obligation is a duty or responsibility that the entity has no practical ability to avoid (CF, 2018).

Source: based on CF, 2018.

Figure 1. *Changes in elements' definitions related to the financial position of an entity*

An asset definition differed between the two Boards (the IASB version is illustrated in Figure 1). According to the FASB version, assets are likely future economic benefits controlled or derived by a certain entity as a result of past transactions or events (FASB, 2002); and liabilities are likely future sacrifices of economic benefits arising from present obligations of a certain entity to transfer assets or provide services to other entities in the future as a result of past transactions or events (FASB, 1985, 6). Both boards have long struggled with the ultimate definition of an asset and a liability.

The significant current changes in the assets and liabilities definitions make it clear that an asset is an existing economic resource, not the ultimate inflow of economic benefits. The liability is an obligation to transfer an economic resource, not the ultimate outflow of economic benefits. These changes are significantly based not on describing both in terms of an expected flow of benefits. The latter had previously been interpreted as a probability threshold. Therefore, currently, both the determinations of an asset and a liability do not need to be certain or probable that economic benefits will arise - their flow expectations are deleted from the new concepts. Only a low probability of economic benefits might affect the decision to recognise and measure the asset (CF, p. 4.16, 2018). A low probability of economic benefits transferring might affect the decision to recognise and evaluate a liability (CF, p. 4.38, 2018). However, the intentions of the IASB to redefine the asset and liability have raised new problems in understanding them correctly and, as a consequence, new misinterpretations (see Figure 2).



Source: based on Cade et al., 2019.

Figure 2. Differences between intentions of new assets and liabilities definitions and misinterpretations on the conceptual level

In the Draft Document states do not need to be persuaded or even possible that the source will bring economic profits. It is only required that the economic resource already exists and that there is at least one situation to bring economic benefit (IASB, 2015). For the asset presence, there must be potential to create economic benefits (IASB, 2015, p. 40), for the liability – potential to require the entity to transfer an economic resource to another party (IASB, 2015, p. 43).

Figure2 illustrates that after the changes in 2018, the economic resource has acquired a definition of the current right that can generate economic benefits, and a current obligation has become a necessity that the entity has no practice ability to avoid. That is, the content remains unchanged in substance but a different formulation. As relevant Mary Tokar, International Accounting Standards Board member remarked: “Sometimes changing words in a standard encourages a re-examination of past practices” (Tokar, 2016). It is well explained the changes in the Conceptual Framework. So, *the reason that led to changes in the asset and liability formulations were the direct misinterpretations of probability or expected economic benefits* (see Figure 2). Therefore, to improve the common understanding and research for new more relevant asset and liability definitions in 2016 the IASB conducted a survey that has been mentioned (IASB, 2016).

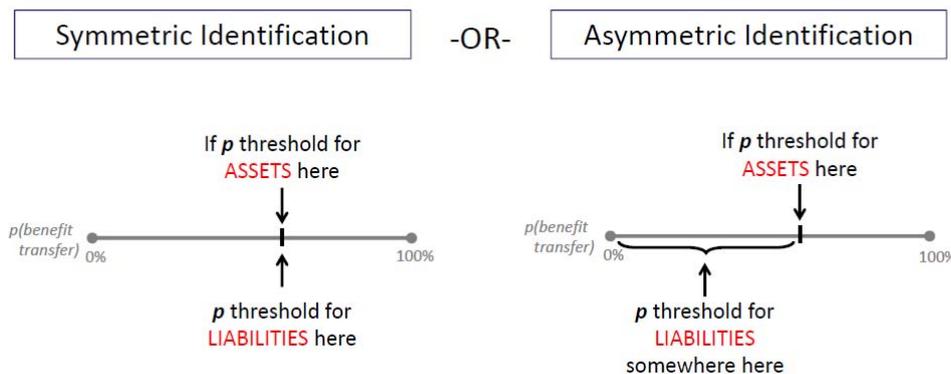
Among participants were seniors (three years' experience) and beginners (after accounting training) in accounting near three hundred Amazon.com's Mechanical Turk workers. The concentration on a non-accountant population is relevant, as is the subsequent comparison of the non-accountant results against results from those with some accounting experience (Cade et al., 2019). The respondents needed to consider the situations in terms of different probability thresholds and different asset and liability definitions. They got questions about each situation about (a) whether an asset exists for the payee, or b) whether there is an obligation for the payer in the ordinary transaction (Cade et al., 2019). We have summarised the obtained results (see Table 1) that are too useful in this research.

Table 1. Proportions of participants’ positive responses about asset and liabilities existence

№	Probability Threshold	ASSET		LIABILITY		
		20%	80%	1%	20%	80%
1	No Definition	37%	87%	62%	60%	65%
2	Old Definition (incl. a <i>probable future economic benefit</i> )	38%	95%	-	67%	70%
		25%*	94%*			
3	New Definition (incl. a <i>potential future economic benefit</i> )	78%	94%	-	75%	85%
		60%*	92%*	81%*	84%*	89%*

Note. \* Responses of experienced experts in accounting.  
Source: based on Cade et al., 2019.

Table 1 illustrates the second set explore objective – survey the understanding of the probability threshold before and after changes in asset and liability definitions. Consequently, the survey results showed that the old definitions did not affect the judgment of the assets and liabilities’ existence. As we can see, the new formulations have helped to understand the IASB intent better but have not eliminated the problem of assets and liabilities definitions. In particular, it turns out that the proportion of respondents (62%) with a 1% probability of a liability existence coincides with the proportion of respondents who set a high probability threshold for it - more than 65%. That people attach greater importance to probabilities associated with outflows (relative to inflows) of economic benefits explains from a psychological point of view that humans are more sensitive to negative (relative to positive) information (Rozin and Royzman, 2001; Taylor 1991). As a result, it was found that before changes, participants used a higher probability threshold in recognising assets than in recognising liabilities, but the new changes in the assets/liabilities definition align participants’ judgments more closely with standard-setters’ intentions (Figure 3).



Source: based on Cade et al., 2019.

Figure 3. Reconciliation between intentions of new asset and liabilities definitions and the results of their correct understanding

Figure 3 helps to understand the reason for updating the symmetric prudence in the new Conceptual Framework and accepting the new asset and liability definitions because the symmetrical identification of an asset and liability can ensure consistency between participants and setters. From a mental perspective, individuals prefer symmetry- symmetric objects are judged to be more attractive, symmetric patterns are easier to process, and symmetry symbolises a well-functioning organism or system (Wagemans et al., 2012).

Overall, investigations confirm that people are not experts in probabilistic judgments (Bernstein, 1998), thus simplifying the task to make the necessary decision (Kahneman and Frederick, 2002). In particular, if there is a 100% probability, then the benefit will come, and if the probability is lower than 100%, then there is a threshold, which is subjective for everyone. An example is a lawsuit, where if you win, the liability is zero; if you lose, the liability is 100 (contingent). If you have a 50% chance of losing, then you have an expected value of 50 that cannot be guaranteed as a result in practice. So, it is not useful financial information that helps to achieve the Conceptual Framework's objective. Another example is the indefinite tax items. Guidance on general accounting principles in the US for uncertain tax items requires recognition of the enormous amount (greater than 50% chance) of being paid.

*Therefore*, for the achievement of the third set research objective – find out the consequences of changes for a consistent understanding between setters and practitioners, we may constant that the new definitions of an asset and a liability have the positive consequence of simplifying human judgments from the psychological point of view that led to achieve the common understanding and improve qualitative characteristics of financial information from the conceptual point of view.

If to tell it will rain, some individuals interpret the statement with a 70% chance of rain as the more conclusive qualitative statement “it is going to rain” (Konold, 1989). Moreover, the opinion higher 70% is indicating nearby to 100%. This was consistent with probability before changes. This opinion implied that higher probabilities of a future transfer of an economic benefit would cause individuals to conclude that an asset and a liability exist. In comparison, lower probabilities of the same future benefit transfer would cause them to conclude that no asset or liability happens (Konold, 1989). After including a potential future economic benefit, the situation is changed. It is more explicit because the interpretation “there is 0% chance of rain” is guaranteeing that no asset or liability exists while other interpretation “there is more than 0% chance of rain” consists conjunction “it is going to rain”. It means the existence of an asset and a liability — the appropriate illustration for this explanation in Figure 2. After the changes in the definitions of an asset and a liability in the Conceptual Framework; we found the changes in the important recognition criteria in financial reporting and new derecognition concepts. The current revised recognition criteria refer explicitly to the qualitative characteristics of useful financial information (see Table 2).

Concerning ‘derecognition’, it has not been previously covered by the Conceptual Framework. The newly introduced concept aims to represent both: a faithfully) any assets and liabilities retained after the transaction or other events that directed to the derecognition (including any acquired asset or liability, incurred or created as part of the transaction or events), and b) the change in the assets and liabilities as a result of that transaction or event (IFRS, 2018, p. 11). The first of these two aims can be viewed as representative of a control approach, while the second represents more of a risks-and-rewards approach.

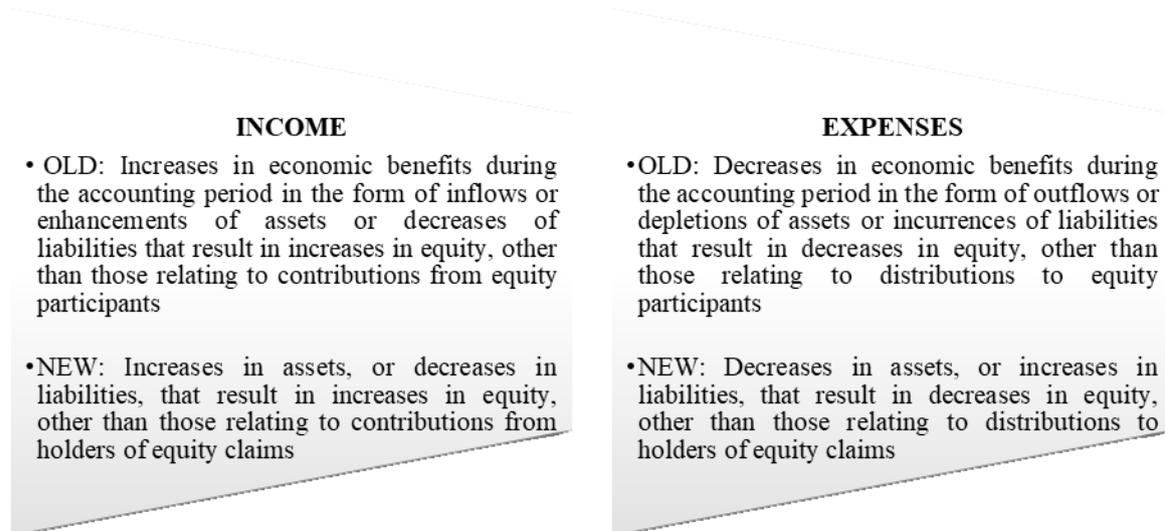
Table 2. Revised recognition and derecognition concepts

<b>Recognition criteria</b>	
<p><b>Relevance</b></p> <ul style="list-style-type: none"> <li>• whether recognition of an item results in relevant information may be affected by:</li> <li>• less probability of an economic benefits flow</li> <li>• existence uncertainty</li> </ul>	<p><b>Faithful presentation</b></p> <ul style="list-style-type: none"> <li>• whether recognition of an item results in a faithful representation may be affected by:</li> <li>• measurement uncertainty</li> <li>• recognition inconsistency (accounting mismatch)</li> <li>• presentation and disclosure</li> </ul>
	
<b>Derecognition criteria</b>	
<p style="text-align: center;"><b>For an asset</b></p> <ul style="list-style-type: none"> <li>• when the entity loses control of all/part of the recognized asset</li> </ul>	<p style="text-align: center;"><b>For a liability</b></p> <ul style="list-style-type: none"> <li>• when the entity no longer has a present obligation for all/part of the recognized liability</li> </ul>

Source: based on CF, 2018; IFRS, 2018.

The IASB views both aims as acceptable. However, in the Conceptual Framework of 2018, the Board did not specify the use of one or another approach. Only the derecognition concept is considered in the current Conceptual Framework – derecognition resulting from a transfer. Ordinarily, a faithful representation of a transfer of an asset or liability, is accomplished by derecognition of the asset or liability with an appropriate presentation and disclosure. Though, in partial cases, it may be necessary to continue recognising a transferred component of an asset or liability together with liability or asset for the proceeds received or paid, also with appropriate presentation and disclosure.

Therefore, we agree that the existence of an asset and a liability is a key determinant of recognition, with relevance, faithful representation, and measurability being the other determinants (see Table 2), due to the normative regulation the process of including to the financial statement an item that meets the definitions of one of the elements of financial statement: an asset, a liability, equity, expenses or income. Given that income and expenses are considered in the revised Conceptual Framework resulting from assets and liabilities changes, the IASB introduced appropriate changes in income and expenses definitions (see Figure 4).



Source: the comparison based on CF, 2018; IASB, 2010.

Figure 4. *Changes in elements' definitions related to the financial performance of an entity*

According to the complications in realising improvements for a consistent understanding between setters and practitioners, it needs to note also that the IASB has introduced the concept of “no practical ability to avoid” in the obligation definition. On the one hand, the cancelling probability gave the explicitly to practitioners, but on the other hand, adding ‘ability to avoid’ gives to raise new questions. For better understanding, the Board explains the following circumstances for this occurrence (CF, 2018, p. 4.32-4.34):

- liability caused by practice - if duty or responsibility arises from the entity’s usual practices, accounting policies, or specific statements;
- if duty or responsibility is restrictive on a certain future action that the entity itself may take, the entity has an obligation if it has no practical aptitude to avoid taking that action;
- the entity can avoid a transfer only by liquidating the entity or by ceasing to trade;
- if any action favourable to the avoidance of the resource’s transfer has more disadvantageous economic consequences than the transfer itself (CF, 2018).

Simultaneously, the IASB is weakening this concept, making it depends on the factors that measure the practical ability to avoid the transfer of an economic resource, the nature of the entity’s duties, or responsibilities. Given the above paragraph (c), the intention to make a transfer or high probability of this transfer is not sufficient reason to believe that there is no practical ability to avoid the transfer. Moreover, this innovation requires the use of additional valuation judgments in practice.

The practice evidenced that old definitions of assets and liabilities have worked well in the past. Therefore, these changes have not been made to appropriate Standards that use the ‘old’ definition of liability such as IAS 37 ‘Provisions, Contingent Liabilities and Contingent Assets’ or IFRIC 21 ‘Levies’. Currently, the users of IFRS 3 and IAS 8 should apply the definitions of an asset and a liability (and additional concepts) according to the Conceptual Framework of 2010. For example, IFRS 3’s users need to decide whether to recognise assets and liabilities as part of a business combination. The IASB acknowledged that in some cases, the application of revised definitions really might change which assets and liabilities can be recognised in a business combination. Eventually, post-acquisition accounting may lead to the

immediate derecognition of these assets or liabilities, resulting in “nominal incomes or losses” that do not reflect economic incomes or losses (Thornton, 2019), including avoidance of double-revisions to accounting policies by entities. Therefore, the IASB is looking for ways to update IFRS 3 without unintended consequences, while the companies have a transitional period. Although the Conceptual Framework, IFRSs, IASs, and IFRIC 21 are now a little inconsistent, the requirements in a Standard or Interpretations will always prevail.

## Conclusions

This article’s purpose was to observe the evolutionary logic of changes in the assets and liabilities definitions in the Conceptual Framework of Financial Reporting, the reasons and consequences of these changes in consistent manners of the setters’ aims. According to planned objectives in this paper, we found the main distinctive characteristics between the new and old definitions of assets and liabilities on the conceptual level and found out the reason that led to these changes. As a result, an asset (not as a physical object) is a set of rights in interpreting a current economic resource that is controlled by an entity as a result of past events, and an obligation (not as a final outflow of economic benefits) is an entity’s current obligation to transfer an economic resource as a result of past. While the old definitions of assets and liabilities worked well in the past, we argued the sufficient reasons for the new definitions. These reasons were examined: 1) different interpretations of probability and expected benefits; 2) asymmetric asset and liability identification. The obtained different formulations of these interpretations encourage a rethinking of past practices and return the symmetry of assets and liabilities identification.

Based on the research of the revised Conceptual Framework for financial reporting, we examined the meaning of the probability threshold in asset and liability recognition before and after changes. The results showed that the old asset and liability definitions did not affect judgments about their availability, and according to the psychological perspective, participants used a higher probability threshold in recognising assets than in recognising liabilities. Even under the same conditions, liabilities are more frequently identified than assets. After the probability threshold of assets and liabilities definitions was abolished, the observed experiments have shown that more people interpret the new assets and liabilities definitions symmetrically. As in the conceptual, as in the psychological point of view, the symmetry is merit. It gives a more significant consistency (but not ideally) with the IASB’s intent. In this way, the effects of new changes in asset and liability definitions improve the setters’ goals and better bring into line participants’ judgments with the setters’ intentions.

Among the new changes that related to the new asset and liability definitions it was found (1) the revised income and expenses definitions due to their link with assets and liabilities changes; (2) the changes in the recognition criteria that are important in financial reporting and (3) new derecognition concepts. According to the current revised recognition criteria that refer explicitly to the qualitative characteristics of useful financial information, we conclude that the existence of assets and liabilities is a key determinant of recognition, with relevance, faithful representation, and measurability being the other determinants.

Researching the main question “Is potential or probability effective in asset and liability definitions?”, we did not give an alternative definition because the current asset (or liability) only needs to have “a 0% probability” of a future economic benefit (sacrifice of benefits) to

exist potentially. For a better description, it was given an example, the interpretation “there is 0% chance of rain” is guaranteeing that no asset or liability exists while other interpretation “there is more than 0% chance of rain” consists conjunction “it is going to rain”. It means an asset and a liability exists. Future research could continue the investigation of this idea.

In sum, despite potential limitations, we believe that the revision of an asset and a liability definition, excluding probability, has led to a reduction in misunderstanding the setters’ intent by practitioners. Individuals will judge the existence of assets and liabilities based on solely on the conceptual statements. The new phrase in the meaning of current obligation, “no ability to avoid” was considered a disadvantage that complicates the feasibility of innovations because it requires the use of additional valuation judgments in practice, similarly to probability. However, it is difficult to imagine the ideal accounting concepts in practice because while some experts state that the revised Conceptual Framework should get the highest praise, others, including scientists, concern about sufficient requirements of theoretical changes rather than practical consequences. So, practitioners need to understand when looking at things that could be seen to be inconsistent with natural reasoning, that this is a potential cost in terms of the effectiveness of financial reporting.

Drawing on the observed in this article psychology research, we have been argued that the term potential implies a lower probability than the terms expected and probable flows. According to the experiment, the threshold level for excepting an asset or a liability arguably decreases. To better understand the potentiality, individuals are recommended to judge the existence of assets and liabilities using a more frequent basis. This recommendation keeps true regardless of the requirements of certainty or sensitivity to probability variations when judging asset and liability existence.

Therefore, we constant that the new definitions of an asset and a liability including a potential future economic benefit, have the positive consequence of simplifying human judgments from the psychological point of view that led to achieve the common understanding and improve qualitative characteristics of financial information in conceptual point of view. The direct evidence of conceptual improvement is symmetric prudence as support of financial statements’ fundamental qualitative characteristics – faithful representation. This research is limited to other changes in the revised Conceptual Framework for Financial Reporting. Future research should further investigate the main updated accounting concepts of this fundamental document, particularly related to the reporting entity, presentation, and disclosure; asymmetry in treating gains and losses; definitions of equity and supporting discussion; materiality.

## References

- Aharony, J., & Dotan, A. (2004). A comparative analysis of auditor, manager, and financial analyst interpretations of SFAS 5 disclosure guidelines. *Journal of Business Finance & Accounting*, 31(3-4), 475-504.
- Amer, T., Hackenbrack, K., Nelson, M. (1994). Between-auditor differences in the interpretation of probability phrases. *Auditing: A Journal of Practice & Theory*, 13(1), 126-136.
- Arkes, H. R. (1991). Costs and benefits of judgment errors: implications for debiasing. *Psychological Bulletin*, 110(3), 486-498.
- Basu, S. (1997). The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics*, 24(1), 3-37.

- Bernard, V., & Schipper, K. (1994). Recognition and disclosure in financial reporting (Unpublished dissertation). University of Michigan, Ann Arbor, MI.
- Bernstein, P. L. (1998). *Against the gods: The remarkable story of risk*. New York, NY: Wiley.
- Botosan, C. A., Koonce, L., Ryan, S. G., Stone, M. S., & Wahlen, J. M. (2005). Accounting for liabilities: conceptual issues, standard-setting, and evidence from academic research. *Accounting Horizons*, 19(3), 159-186.
- Cade, N. L., Koonce, L., Mendoza, K.I., Rees, L. & Tokar, M. B. (2019). Assets and Liabilities: When Do They Exist? *Contemporary Accounting Research*, 36(2), 553-587. doi: [10.1111/1911-3846.12479](https://doi.org/10.1111/1911-3846.12479)
- CF.(2018). Conceptual Framework for Financial Reporting. *Croner-i: HR-Tax-H&S-Audit&Accounting*. Available online at [https://library.croneri.co.uk/cch\\_uk/iast/misconceptualfram2018-201803](https://library.croneri.co.uk/cch_uk/iast/misconceptualfram2018-201803) (08/06/2019)
- Deloitte. (2016). Deloitte Foundation. Trueblood Case Series. Available at <http://www2.deloitte.com/us/en/pages/about-deloitte/articles/trueblood-case-studies-deloitte-foundation.html>
- Dickhaut, J., Smith, V., Xin, B., Rustichini, A. (2013). Human economic choice as costly information processing. *Journal of Economic Behavior and Organization*, 94, 206-221.
- FASB. (1985). Elements of Financial Statements, Statement of Financial Accounting Concepts. No. 6. Norwalk, CT: FASB.
- FASB. (2002). Accounting for Costs Associated with Exit or Disposal Activities. Statement of Financial Accounting Standards No. 146. Norwalk, CT: FASB.
- FASB and IASB. (2007). Joint International Working Group on Leasing. Topic: Asset and Liability Definitions – Existing Versions and Working Drafts of Proposed Revisions. London, England 15 February 2007.
- Harrison, K. E., & Tomassini, L. A. (1989). Judging the probability of contingent loss: An empirical study. *Contemporary Accounting Research*, 5(2), 642-648.
- IASB. (2015). Exposure Draft: Conceptual Framework for Financial Reporting.
- IASPlus. (2018). Conceptual Framework – Comprehensive IASB Project. Available online at <https://www.iasplus.com/en/projects/completed/framework/cf-iasb> (08/06/2019)
- IFRS. (2018). Conceptual Framework for Financial Reporting. IFRS: Project Summary. March 2018. Available at <https://www.ifrs.org/-/media/project/conceptual-framework/fact-sheet-project-summary-and-feedback-statement/conceptual-framework-project-summary.pdf> (08/06/2019)
- Jiambalvo, J., & Wilner, N. (1985). Auditor evaluation of contingent claims. *Auditing: A Journal of Practice & Theory*, 4, 1-11.
- Kahneman, D., & Tversky, A. (1979). Prospect theory: An analysis of decision under uncertainty. *Econometrica*, 47 (2), 263-292.
- Kahneman, D., & Tversky, A. (1982). Variants of uncertainty. *Cognition*, 11(2), 143-157.
- Kahneman, D., & Frederick, S. (2002). Representativeness revisited: Attribute substitution in intuitive judgment. In T. Gilovich, D. Griffin, and D. Kahneman (eds.) *Heuristics and Biases: The Psychology of Intuitive Judgment*. Cambridge University Press, Cambridge, UK, 49-81.
- Kieso, D. E., Weygandt, J. J., & Warfield, T. D. (2016). *Intermediate Accounting*. 16<sup>th</sup> Edition. Hoboken, NJ: John Wiley & Sons.
- Konold, C. (1989). Informal conceptions of probability. *Cognition and Instruction*, 6(1), 59-98.
- Libby, R., Bloomfield, R., & Nelson, M. W. (2002). Experimental research in financial accounting. *Accounting, Organizations and Society*, 27(8), 775-810.
- Merigó, J. M., & Yang, J. B. (2017). Accounting Research: A Bibliometric Analysis. *Australian Accounting Review*, 27(1), 71-100. <https://doi.org/10.1111/auar.12109>
- Raghunandan, K., Grimlund, R. A., & Schepanski, A. (1991). Auditor evaluation of loss contingencies. *Contemporary Accounting Research*, 7(2), 549-569.
- Rozin, P., & Royzman, E. B. (2001). Negativity bias, negativity dominance, and contagion. *Personality and Social Psychology Review*, 5(4), 296-320.

- Slovic, P., Fischhoff, B., & Lichtenstein, S. (1982). *Facts vs. perceived fears: Understanding perceived risk*. In D. Kahneman, P. Slovic, and A. Tversky (eds.) *Judgment Under Uncertainty: Heuristics and Biases*. Cambridge University Press: Cambridge, UK, pp. 463- 492.
- Storey, R. K., & Storey S. (1998). *Financial accounting series special report: The framework of financial accounting concepts and standards*. Norwalk, CT: FASB.
- Taylor, S. E. (1991). Asymmetric effects of positive and negative events: The mobilisation- minimisation hypothesis. *Psychological Bulletin*, 110(1), 67-85.
- Thornton, G. (2019). As instinct for growth. IFRS News. Special Edition. A revised Conceptual Framework Financial Reporting. June 2018. Retrieved from <https://www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/2018/ifrs-news---a-revised-conceptual-framework-for-financial-reporting.pdf> (08/06/2019)
- Tokar, M. (2016). IFRS - IASB member Tokar responds to academic paper. Available online at <https://www.ifrs.org/news-and-events/2019/06/iasb-member-tokars-response-to-academic-paper-on-when-assets-and-liabilities-exist/>
- Wagemans, J., Elder, J. H., Kubovy, M., Palmer, S. E., Peterson, M. A., Singh, M., & R. von der Heydt, R. (2012). A century of Gestalt psychology in visual perception: I. Perceptual grouping and figure-ground organisation. *Psychological Bulletin*, 138(6), 1172-1217.
- Watts, R. L. (2003a). Conservatism in accounting. Part I: explanations and implications. *Accounting Horizons*, 17(3), 207-221.
- Watts, R. L. (2003b). Conservatism in accounting, Part II: evidence and research opportunities. *Accounting Horizons*, 17(4), 287-301.

### **Acknowledgments**

Not applicable.

### **Funding**

Not applicable.

### **Conflict of Interests**

No, there are no conflicting interests.

### **Open Access**

This article is licensed under a Creative Commons Attribution 4.0 International License, which permits use, sharing, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license, and indicate if changes were made. You may view a copy of Creative Commons Attribution 4.0 International License here: <http://creativecommons.org/licenses/by/4.0/>.