



**30 Cannon Street, London EC4M 6XH, England**  
**Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411**  
**Email: [iasb@iasb.org](mailto:iasb@iasb.org) Website: <http://www.iasb.org>**

**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at the World Standard Setters meeting, to assist them in following the discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*Note: These notes are based on the staff papers prepared for the World Standard Setters meeting. Paragraph numbers correspond to the paragraph numbers in the staff papers.*

## **INFORMATION FOR OBSERVERS**

***WORLD STANDARD SETTERS MEETING, SEPTEMBER 2006, LONDON***

***AGENDA PAPER IA***

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### **Conceptual Framework**

#### **Asset Definition**

#### **INTRODUCTION**

1. Over the last six months or so, the IASB and FASB (the Boards) have commenced discussion of Phase B of the Conceptual Framework project, which involves consideration of the elements of financial statements, as well as recognition. In particular, the Boards have focussed on developing a proposed working definition of an asset.
2. Development of the asset definition is the first step of a multi-step process to determine how to account for an asset. This paper, and the Boards' discussions to date, focuses on the existence of an asset and NOT on whether it should be recognized (for example, given practicality concerns) or how it should be measured. Therefore, conclusions reached as to

what meets the definition of an asset do not necessarily mean that all assets (as defined) will be recognized in financial statements.<sup>1</sup>

### **Purpose of World Standard Setters' Discussion**

3. The objective of this session is to inform, and solicit views of, World Standard Setters about the proposed working definition of an asset.
4. World Standard Setters will have an opportunity to discuss the proposed working definition in small groups with Board members and project staff. Following small group discussions, feedback will be discussed by the group as a whole in plenary session.

### **Purpose of this Paper**

5. This paper summarizes the aspects of the proposed working definition of an asset and amplifying text that the Boards are currently considering.

### **Structure of the Paper**

6. The remainder of this paper is structured as follows:
  - (a) Definition of an Asset – the need for change and current proposal
  - (b) Questions for discussion

## **DEFINITION OF AN ASSET – THE NEED FOR CHANGE AND CURRENT PROPOSAL**

### **The need for change**

7. World Standard Setters might recall a presentation by Jim Leisenring at the September 2004 meeting, during which, among other things, he pointed out some of the shortfalls of the current definitions of an asset in the existing IASB and FASB frameworks.<sup>2</sup> The shortfalls include the following:

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<sup>1</sup> Recognition is scheduled for discussion by the Boards at a later date.

<sup>2</sup> See the Appendix to this paper for the existing definitions of an asset.

- (a) *Likelihood*—both the IASB and FASB definitions have been misinterpreted as implying that there must be a certain probability (FASB), or expectation (IASB), of future economic benefits before the definition is met. Thus, some believe that when there is a low probability, or expectation, of future economic benefits, the asset definition is not met. That is not the intent, as is made clear by a footnote to the FASB definition. However, to avoid this continued misinterpretation, the working definition removes any reference to likelihood. We<sup>3</sup> think it is sufficient that the economic resource in question has the ability to generate favourable cash flows to the entity. If there is any question of likelihood to be considered, that might be in assessing whether an asset qualifies for recognition or in measurement (recognition and measurement will be considered at a later date)—not in the definition of an asset.
- (b) *Future economic benefits*—this phrase, used in both the IASB and FASB definitions, implies that there must be some future flow of economic benefits in order that an asset exists and directs attention towards seeking to identify those future flows. However, we think that is the wrong focus. What we should focus on is whether something with the capability of generating future cash inflows, or reducing future cash outflows—an economic resource—exists at the present time. That existence is not dependent on the future. For example, a lottery ticket, or an unexercised stock option, is a present economic resource, even though future economic benefits might not flow from that resource. We think that by focussing on *present economic resources*, rather than future economic benefits, this more appropriately captures the notion we need.
- (c) *Past transaction or event*—in applying both the IASB and FASB definitions, some place undue emphasis on seeking to identify the past transaction or event that gave rise to an asset. We think that it is unnecessary to focus on identifying a past transaction or event. Indeed, it can be a distraction, leading to debates about which event is the triggering event, rather than focusing on whether the economic resource and the rights to it exist at the balance sheet date. The method of acquisition of rights or other access does not affect whether the item under consideration meets the essential characteristics of an asset at the

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<sup>3</sup> “We” is used in this paper to refer to staff working on the asset definition aspect of the conceptual framework project. These views do not necessarily represent the views of the Boards, which are reached only after due process, or of other staff members.

present time. We think that references to ‘past transaction or event’ were included in the definitions, primarily to exclude the future. We propose, therefore, to focus on the need for the essential characteristics of an asset to exist ‘at the present’ (i.e., a *present* right or other privileged access to a *present* economic resource). This also has the advantage that the essential characteristics must exist today—so they can’t be ones that will not arise until the future, or that existed in the past, but no longer exist at the balance sheet date.

(d) *Control*—in applying the existing definitions, some view *control* of a resource (IASB), or of probable future economic benefits (FASB), as being used in the same sense as that used to determine whether one has control in a business combination, or for purposes of consolidation accounting. We think that replacing “control” with “rights or other privileged access” avoids this problem. This latter idea, derived from the UK *Statement of Principles for Financial Reporting’s* (UK SOP),<sup>4</sup> better reflects the manner in which an entity is associated with economic resources in today’s complex business world.

8. The proposed working definition of an asset seeks to overcome the problems identified in the previous paragraph. It also draws on more recent thinking by national standards setters, and seeks to converge the existing IASB and FASB definitions. In developing the working definition, we have also given greater consideration, than previously, to contractual promises and have sought to clarify that such promises can give rise to assets for the holder of the promise.

### **Current proposal**

9. The following working definition of an asset, and its essential characteristics, is the latest, discussed by the Boards in July 2006:

An *asset* is a present economic resource to which an entity has a present right or other privileged access.

An asset of an entity has three essential characteristics:

- (a) There is an economic resource.

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<sup>4</sup> Accounting Standards Board, *Statement of Principles for Financial Reporting*, October 1999.

- (b) The entity has rights or other privileged access to the economic resource.
- (c) The economic resource and the rights or other privileged access both exist at the financial statement date.

10. Based on the discussions to date, the Boards propose to provide amplifying text to explain certain aspects of the definition. Parts of the draft amplifying text are reproduced below, to assist in understanding the essential characteristics of the working definition.

**An Economic Resource**

- 11. Economic resources are the scarce means that are useful for carrying out economic activities, such as consumption, production, and exchange. That is, they have the capacity to eventually result in cash inflows to the entity or a reduction in cash outflows from the entity.
- 12. The relationship between economic resources and cash flows may be direct or indirect and might arise from a single resource, or from a combination of resources.
- 13. The most obvious evidence of an economic resource is that it has a market price (although the lack of a market price does not preclude an item from being an economic resource). Most things that are commonly bought and sold are economic resources. Similarly, most things that creditors commonly accept in settlement of liabilities are economic resources and anything that is commonly used to produce goods or services, whether tangible or intangible and whether or not it has a market price or is otherwise exchangeable, is also an economic resource.
- 14. As long as an item has the capacity, at the financial statement date, to give rise to cash inflows or a reduction in cash outflows, then there is an economic resource. That is, as long as there is some likelihood of cash inflows or a reduction in cash outflows, there is an economic resource.
- 15. Economic resources include: inventory, plant, equipment, mineral deposits, patents, goodwill, rights to receive services, cash, claims to cash, and ownership interests in other entities.

16. An asset can result from contractual arrangements. In these circumstances, the economic resource is the contractual promise that has the capacity to give rise to cash inflows or a reduction in cash outflows. Contracts generally involve exchanges of promises. For example, in the case of a contract to buy a specified quantity of corn in the future at a fixed price, the buyer's economic resource is not the corn to be grown and harvested in the future. Rather, it is the seller's contractual promise to stand ready to exchange a specified quantity of corn for a fixed payment. Until the promise is performed, the present economic resource of the buyer is the seller's promise. The value of that economic resource will increase if the price of corn rises above the agreed-upon price (for example, if the supply of corn becomes limited). The corn is not the buyer's economic resource (the seller may not yet have grown corn or have any corn on hand). The promise might be sold, with the contract never being physically settled in corn. Alternatively, when the seller delivers the corn (or such other time as ownership is transferred), the seller's promise is fulfilled. That economic resource is replaced by a new economic resource—corn—to which the buyer has property rights. At that time, it is the corn that constitutes the buyer's economic resource. In either case, the buyer has an economic resource capable of generating future cash inflows.
17. When there is no party external to the entity against which the entity can seek enforcement of a promise (i.e., there is no external obligor), there is no economic resource. Thus, an asset cannot arise as a result of an entity making a promise to itself.

**Rights or Other Privileged Access to an Economic Resource**

18. Rights or other privileged access are not, themselves, economic resources. Rights are what associate economic resources with an entity. Rights provide an entity with the means to benefit from economic resources. Rights are a mechanism that society uses as a way to distinguish who is entitled to specific resources and to facilitate exchanges of resources. An economic resource might become associated with other parties that obtain the right from the entity. In that case, the other party now has the asset. However, the economic resource itself might not have changed.
19. An entity's association with economic resources might be represented, for example, by property rights (such as the right to possess, use, and enjoy a parcel of land), contractual

rights, or other privileged access. In the case of assets where the association of the entity with the economic resource is established by property rights or by other privileged access, there is no corresponding obligation of another party. However, for assets where the association is established by contractual or equivalently enforceable rights, another party must have a corresponding obligation and, thus, a liability.

20. Rights can be obtained in various ways; often they are obtained by ownership of an item. Such ownership usually gives the owner access to a number of means of deriving eventual cash inflows or a reduction in cash outflows from the resource, including by using and enjoying the resource, selling or exchanging it, or exploiting its value by, for example, pledging it as security for borrowing.
21. However, legally enforceable rights to an economic resource can be obtained without having ownership of the resource, as is the case with contractual rights. For example, when property is leased or when an entity has rights only to cash flows arising from an item, such as with a contract providing rights only to interest flows from an underlying debt instrument.
22. Other legally enforceable rights that give rise to assets include the right to require other parties to make payments or render services and the right to use a patent or trademark. Thus, legally enforceable rights include, among other rights, contractual rights, rights under promissory estoppel, and property rights.
23. An entity need not have an *exclusive* right to have an asset. Rights may be single (held or imposed solely by the entity) or shared (held or imposed in conjunction with others). Two or more entities might have different rights to economic resources arising from the same item at the same time, or might have rights to the same economic resource at different times. For example, lease arrangements unbundle the economic resources embodied in leased property by giving the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value. Also, time-share property owners have the rights to use a property during specified time periods. Each entity has an asset based on the rights that it has.
24. Rights also might be enforceable by other external means that are equivalent to legal enforcement, such as those arising within a self-regulatory structure, such as a professional

organization. If rights enforced by such other means are enforced similarly to how rights would be legally enforced (even though the consequences of enforcement might differ), they may be regarded as the equivalent of legally enforceable rights.

25. An entity also might obtain cash inflows or a reduction in cash outflows in the absence of legally enforceable rights. For example, an entity might have no legally enforceable rights to secret know-how, or an unpatented invention, but can use or sell the knowledge or invention (to generate cash inflows) and restrict, or otherwise prevent or limit, others' access. Therefore, the ability to restrict others' access also creates an asset of an entity in that it creates an advantage beyond the common advantages of others (that is, privileged access).
26. Rights or other access that give an entity no advantage beyond the common advantages of others because they are available to all do not qualify as assets. A right that is not restricted, such as a right to sue, is not an asset of an entity. Having a public road outside an entity's property might seem like an asset to that entity. However, as long as there are no restrictions as to who can drive on that road, then the right to drive on that road is not an asset of the entity (although the proximity of the road might add value to the entity's property)—there is no advantage, or privileged access, to the entity. A right to use a road, such as a right to operate a truck on a road from which the rights-holder might otherwise be excluded, may, however, be an asset of an entity if it might eventually lead to cash inflows or a reduction in cash outflows.
27. Every asset is an asset of some entity;<sup>5</sup> moreover, no asset can simultaneously be an asset of more than one entity. The entity having rights or other privileged access to an economic resource is the one that can: exchange those rights or permit access, use the resource to which it has the rights to produce goods or services or reduce other expenditures, exact a price for others' use of the rights or access, use them to settle liabilities, hold them, or perhaps distribute them to owners.
28. Economic benefits from an economic resource must accrue to the entity. An asset does not include an economic resource that the entity has rights or other access to, but that generates

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<sup>5</sup> However, the entity may not necessarily be a reporting entity that prepares financial statements including that asset, or it may be society as a whole.

eventual cash inflows or a reduction in cash outflows that only go elsewhere (for example, when the entity is acting in a fiduciary capacity, as a trustee, and has no ability to benefit from economic resources that it holds in that capacity other than, perhaps, to extract a fee for services provided).

***The Relationship between Rights and Control***

29. Control refers to the ability to direct, manage, or have power over something so as to obtain or access benefits, or to increase, maintain or protect those benefits (benefits that have the capacity to give rise to cash inflows). As noted earlier, to have an asset an entity must have rights or other privileged access to an economic resource. What is important in the case of rights or other privileged access to an economic resource is not necessarily whether an entity can direct, manage, or have power over the entire economic resource. Rather, it is whether the entity can direct, manage, or have power over its rights to the resource. Thus, a 10 percent interest in an economic resource is an asset. The entity does not control the entire economic resource—it cannot direct, manage, or have power over the entire economic resource. However, the entity does control the 10 percent interest. The role of control for assets existing other than by means of property rights is in determining whether the entity can direct, manage, or have power over the rights, limits, or restrictions that associate the entity with the economic resource.
30. Another party's restriction that happens to also benefit the entity is not an asset of the entity unless the entity can direct, manage, or have power over the restriction. For example, an agreement entered into between team A and one of its players that precludes team A from trading the player to team B (a no-trade clause) might be considered an asset of team C if team C is in competition with team B and would prefer that player not be traded to team B. However, team C has no right to the economic resource (the restriction)—it does not direct, manage, or have power over the restriction—and, hence, team C does not have an asset.

**Present at the Financial Statement Date**

31. The entity must have rights or other privileged access to the economic resource at the financial statement date—i.e., it must have *present* rights—and the economic resource must

exist at that date—i.e., it must be a *present* economic resource. This means that the asset must have arisen from past transactions or other past events. Often assets are obtained by purchasing or producing them, but other transactions or events may give rise to assets. Examples include the discovery of mineral deposits and the receipt of land or buildings from a government as part of a program to encourage economic development in an area. The means of acquiring rights or other access does not affect whether the item under consideration meets the essential characteristics of an asset at the present time (that is, the history of how the asset arose or was obtained does not matter), although it might provide evidence to help in the assessment as to whether the item is an asset.

32. Transactions or other events expected to occur in the future do not in themselves give rise to assets today. An intention to purchase inventory does not, itself, meet the definition of an asset. Equipment to be acquired next year, which the entity has not already contracted for, does not give rise to a present right to that equipment today.
33. The corollary is that an entity still has an asset if the transactions or other events that ultimately transfer, use up or destroy the economic benefits associated with the resource are in the future. For example, an asset remains even if the entity has decided that it will sell or stop using a resource in the future.
34. It is necessary that *both* the rights or other privileged access, and the economic resource exist. If rights have been transferred to others, but the economic resource still exists, then the entity no longer has an asset. If the rights are present, but the economic resource no longer exists (for example, a share certificate establishing rights to a residual interest in a company that has been wound-up), then the entity no longer has an asset.

## **EXAMPLES**

35. The following chart applies the working definition of an asset to two specific fact situations to consider some of the implications of the definition.

<b>Asset</b>	<b>Economic Resource</b>	<b>Rights or Other Privileged Access</b>	<b>Both Presently Exist</b>
<b>Freehold interest in land</b>	Freehold interest in land can be indirectly used in the production of goods for sale or provision of services, or separately sold, each of which can result in future cash inflows.	Established by property right.	Economic resource is observable and rights are set out in ownership documentation.
<b>Internally-developed list of past customers</b>	Internally-developed list of past customers can be used to send advertisements of goods and services for sale, or separately sold, each of which results in future cash inflows.	Established by ownership rights or other privileged access as entity has ability to restrict others' access to the list.	Economic resource and ability to restrict others' access are observable.

### QUESTIONS FOR DISCUSSION

36. To assist the Boards in testing the proposed working definition of an asset, below are questions to consider and to discuss in the breakout sessions.

- Q1.** Do you agree that it is preferable not to refer to likelihood of economic benefit in the asset definition?
- Q2.** Do you agree with the focus on present economic resources, rather than future economic benefits?
- Q3.** Do you agree that it is unnecessary to specify the need for a past event if we focus on the need for “present” rights and other privileges?
- Q4.** Does “present right or other privileged access” work better than “control”?
- Q5.** Do you agree with the analysis of contractual arrangements in paragraph 16?
- Q6.** Does the proposed working definition, together with its essential characteristics and amplifying text, appear to be an improvement (clearer, more appropriately captures the right items, etc.) on existing definitions?

## APPENDIX

### Existing Asset Definitions

IASB	An <b>asset</b> is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. (paragraph 49)
FASB	<b>Assets</b> are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. (paragraph 25)
Australia	" <b>Assets</b> " are future economic benefits controlled by the entity as a result of past transactions or other past events; and "control of an asset" means the capacity of the entity to benefit from the asset in the pursuit of the entity's objectives and to deny or regulate the access of others to that benefit. (paragraph 14)
Canada	<b>Assets</b> are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained. (paragraph 29)
Germany	An <b>asset</b> is a resource controlled by an enterprise as a result of past events. (paragraph 66)
Japan	<b>Assets</b> are economic resources or their equivalents that the reporting entity controls as a result of past transactions or events. (paragraph 4)
New Zealand	<b>Assets</b> are service potential or future economic benefits controlled by the entity as a result of past transactions or other past events. (paragraph 7.7)
United Kingdom	<b>Assets</b> are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events. (paragraph 4.6)
CFA Institute – Comprehensive Business Reporting Model (page 19) <sup>6</sup>	An enterprise must recognize an economic resource as an asset in the financial statements when all of the following conditions are met: a. The resource is a present right or other access to a future benefit that will flow to the company and will contribute directly or indirectly to future net cash inflows; b. The right to the future benefit is controlled by the company; c. There is a nonzero probability that the benefit will occur; d. The right to the future benefit is separable from the company; that is, it can be transferred to an external party; e. The right to the future benefit is the result of past events; and f. The fair value of the right to future benefits can be measured.

<sup>6</sup> A *Comprehensive Business Reporting Model: Financial Reporting for Investors*, CFA Centre for Financial Market Integrity, September 2005. Note that this definition mixes both the definition of an asset and recognition criteria.