

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



This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's 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 paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: February 2006, London
Project: Conceptual Framework – Asset Definition
(Agenda Paper 4B)

INTRODUCTION

Asset Definition

1. The IASB and FASB (the Boards) recently commenced discussion of Phase B of the Conceptual Framework project, which involves the consideration of the elements, recognition and measurement attributes, by discussing 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.¹

¹ Recognition is scheduled for discussion by the Boards later in 2006.

Purpose of SAC Discussion

3. The objective of this session is to solicit views of SAC members about the proposed working definition of an asset.
4. SAC members 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. This is the same proposed working definition that the IASB will be considering immediately before the SAC meeting.

Structure of the Paper

6. The remainder of this paper is structured as follows:
 - (a) Definition of an Asset – current proposal and rationale for the following parts of the definition:
 - (i) Of an entity
 - (ii) Rights
 - (iii) Other privilege
 - (iv) Present right or other privilege
 - (v) Ability to generate economic benefits
 - (vi) Cash
 - (b) Questions for discussion

DEFINITION OF AN ASSET – CURRENT PROPOSAL AND RATIONALE

7. To develop an improved and common definition of an asset, the Boards are discussing the following working definition of an asset in February 2006:

An asset of an entity is:

- (a) cash held by the entity;
- (b) a present right of the entity to cash; or
- (c) a present right, or other present privilege, of the entity to a resource that is capable of generating economic benefits to the entity, either directly or indirectly.

For reference purposes, the existing asset definitions of the IASB, FASB and some national standard setters are included in an Appendix to this paper.

8. Based on the discussion to date, the Boards propose to provide amplifying text to explain certain aspects of the definition.

Of an entity

9. The Boards propose to refer to an asset “of an entity” and to the ability to generate economic benefits “to the entity” to focus more directly on things that are relevant to users’ decisions about the entity. Otherwise, one might need to contemplate many candidates as assets that clearly have nothing to do with the entity. An asset in the abstract is a thing of use or value (the dictionary definition). However, for our purposes, the definition is focused in a financial reporting context. Without the requirement that the resource be capable of generating economic benefits “to the entity”, it would be possible for an asset to include something that the entity has rights or other access to, but which generates economic resources that only go elsewhere (for example, when the entity is merely acting as an agent for others).²

Right

10. Rights refers to rights enforceable at law —contractual rights, rights under promissory estoppel, etc. The Boards think that a “*right*” is a more useful notion in a world where access rights can increasingly be carved up and distributed between individuals, as in many financial instruments and securitisation transactions. As another example, lease agreements unbundle

² The existing IASB and FASB definitions of an asset, as well as those of other national accounting standards setters, all link economic benefits to the entity.

the future economic benefits 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. Rights and restrictions may be single (held or imposed solely by the entity) or shared (held or imposed in conjunction with others).

11. Rights seem to work better than control in the lease example referred to above, since an entity can have legal rights to future cash flows arising from the resource, but does not have ownership or control of the resource itself. Rights also seem to work better when one cannot control the actions of another party, but there is some right to a benefit if the other party takes particular actions, such as in the case of renewal options.³ In many cases, control might create rights. For example, in some jurisdictions an individual that controls property through possession might, after some period of time, acquire rights to that property. However, even though control might have a role in determining rights, control seems to be unnecessary when an entity has a right or other privilege.

Other privilege

12. An asset is something an entity has some right or advantage over that others do not have—a privilege. The dictionary definition of a privilege is:

A right, advantage or immunity granted to or enjoyed by a person, or a body or a class of persons, beyond the common advantages of others; an exemption in a particular case from certain burdens or liabilities... or... the possession of special advantages or rights.⁴

13. The staff recommends to the Boards that this captures the notion that they want—ensuring that things that give the entity no rights or advantages, because they are available to all, do not qualify as assets, but those that do create advantages or rights fall within the definition. It is notable that the definition of a “privilege” specifies a right as one of its parts. As a “right” is separately stated, the Boards propose to also refer to “other privilege”. It is proposed that amplifying text will focus on how a privilege may arise from a restriction on others (for example, by charging a fee or toll, or establishing other limiting criteria, for access; by not

³ The Boards intend to explore renewal options and other similar rights in more detail in later 2006.

⁴ Oxford Dictionary Online

making known to others the existence of a resource capable of generating economic benefits to the entity—such as a secret formula; or by entering into an agreement restricting the exchange of an asset to particular parties).

14. Staff propose to refer to a “restriction” on others, rather than “control” over others. Some thesauruses suggest that *restrict* and *control* are synonyms for one another. Other synonyms for *restrict* are words such as *limit*, *curb*, *check*, and *constrain*. Synonyms for *control* include *manage* and *have power over*. However, there also is an alternative stream of synonyms for control that include *rule* and *dictate*, suggesting unilateral abilities, rather than shared abilities. We think that we want to consider shared, as well as unilateral, abilities. For example, an entity might be able to place limits on others’ access to a resource, such as by specifying the circumstances, or time period, during which others’ might use the invention, but might be unable to unilaterally control access to the resource if there are other legal or statutory rights to access. The fact that the entity can place limits on, or exclude, access seems to create an asset. It does not seem necessary to require unilateral control.
15. Another example where restrictions seem to work better than control is when an entity shares a recipe with others, with no entity having exclusive access (or control) over the recipe. Again, an asset would seem to exist if there were overall restrictions on the use of the recipe, even though no one entity may have control. Indeed, the definition of *privilege* contemplates that, in that it refers to privilege being enjoyed by “a person or a body or a class of persons” (emphasis added).⁵ If a third party has to get permission from the entity (perhaps along with permission of others) before it can have access to a resource there would seem to be restrictions giving rise to a privilege.

Present right or privilege

16. Referring to a “right or other privilege” to something in the definition does not specify at what time that right or other privilege must arise. The possibility would arise that one could recognize as assets a right or other privilege that does not exist, but will, or is expected to, arise a long time into the future, or has expired. Therefore, the Boards propose to borrow a word from today’s definition of a liability and specify that the right or other privilege must be

⁵ See definition from Oxford English Dictionary in paragraph 12.

present at the balance sheet date. The Boards plan to include amplifying text to make it clear that future and past transactions or other events do not give rise to assets if there is no present right or privilege.

17. Many current asset definitions refer to a need for there to be “past events” so as to exclude the future. However, if we define an asset to represent a “present right or other privilege,” it seems unnecessary, in addition, to specify that there must have been a past transaction or event. Those rights or other privileges must exist today — so they can’t be ones that will not arise until the future. Equipment to be acquired next year does not give rise to a present right to that equipment. However, if it is a firm commitment, it might give rise to something of value — with the ability to generate favourable cash flows — so that there might be an asset representing a favourable contract, rather than the equipment. To adopt a clear and concise definition of an asset, every word should count. Therefore, the Boards think it unnecessary to include a requirement for there to be a past transaction or event in the definition of an asset.

Ability to generate economic benefits

18. Future *economic benefits* are featured in both the IASB and FASB definitions of an asset.⁶
19. Based on the objective of financial reporting, financial information about economic resources provides financial statement users with information about an entity’s ability to generate favourable cash flows. It follows that the kinds of things that should be reported in the financial statements would be those things that are capable of generating favourable cash flows. References to future economic benefits in the existing definitions of an asset are an indirect way of linking to this objective.
20. For business entities, *economic benefits* are equivalent to favourable cash flows”. The Boards acknowledge that it would be better to refer to cash inflows and remove the subjectivity as to what is a *favourable* cash flow, which can be in the eye of the beholder. At this stage of the project, the Boards have not considered in what circumstances cash flows may be offset and,

⁶ Future economic benefits also are featured in the Australian, Canadian, New Zealand, and UK definitions. The German definition refers to “resources” in the definition of an asset, but explains that a resource is an “inflow of future economic benefits ...” The Japanese definition does not refer directly to economic benefits—rather, it refers to economic resources, but does, in the background discussion, discuss resources in terms of benefits.

hence, whether we should refer to “cash inflows” or “net cash inflows. Thus, for business entities “the ability to generate economic benefits” is the same as “the ability to generate cash inflows”.

21. Economic benefits may be direct or indirect. For example, a toll road operator might directly receive cash in the form of tolls in exchange for the right to travel on the toll road. In other circumstances, the economic benefit might be indirect. For example, the economic benefit arising from restricted access to a secret formula arises only from the use of that formula by the entity. Similarly, the economic benefit arising from a warranty might be reduction of risk of outflows of cash to replace an asset, rather than additional cash inflows. The economic benefit arising from a guarantee might be reduction of risk of not receiving cash inflows, rather than the actual receipt of a cash inflow. It is proposed to indicate this in the definition of an asset by adding the word “directly or indirectly” at the end.
22. The *ability* to generate economic benefits is any potential ability—it does not have to be a certain ability, a likely ability, or an existing ability to generate economic benefits—any non-zero likelihood creates a potential ability. The amplifying text will explain that any ability to generate economic benefits is sufficient to satisfy this part of the definition of an asset and that there is no need for any assessment as to the likelihood of the ability to generate economic benefits.

Cash and accounts receivable

23. Cash can be viewed as meeting part (c) of the proposed working definition of an asset in that cash is a medium of exchange. Cash is legal tender that can be readily tendered in exchange for other resources that are capable of generating economic benefits to the entity. However, for business entities, cash is the ultimate economic benefit. Given possible ambiguity as to whether cash meets the definition of an asset, it is proposed to explicitly state in the definition that cash held by the entity is an asset of the entity.⁷ As accounts receivable, prepayments and other items represent a contractual right of an entity to receive cash or a right to receive a resource in the form of goods or a service, each of which is capable of

⁷ This is the same approach as has been taken by the IASB, FASB, and several other accounting standard setters in defining a financial asset. Cash is explicitly listed as a financial asset.

generating economic benefits to the entity, the Boards propose to also specify separately that an asset of an entity is “a present right of the entity to cash”.

EXAMPLES

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

| Asset | Present privilege | Resource | Capable of generating economic benefits |
|--|--|-----------------------|--|
| Freehold interest in land | Established by contractual right | The freehold interest | 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 is capable of generating future cash inflows. |
| Internally-developed list of past customers | Established by virtue of an advantage over other entities that do not have the list. | The list | Internally-developed list of past customers can be used to send advertisements of goods and services for sale, or separately sold, each of which is capable of generating future cash inflows. |

QUESTIONS FOR DISCUSSIONS

25. 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.** Does “present right or other present privilege” work better than “control”?
- Q2.** Do you agree that it is unnecessary to refer to probability of economic benefit in the asset definition?
- 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 the proposed working definition appear to be an improvement (clearer, more appropriately captures the right items, etc.) on existing definitions?

Q5. Does the proposed working definition appear to: (i) include items that you would not consider should be included in the definition of an asset; or (ii) exclude items that you would consider should be included in the definition of an asset?

APPENDIX

Existing Asset Definitions

| | |
|---|---|
| IASB | An asset 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 | Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. (paragraph 25) |
| Australia | " Assets " 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 | Assets 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 asset is a resource controlled by an enterprise as a result of past events. (paragraph 66) |
| Japan | Assets are economic resources or their equivalents that the reporting entity controls as a result of past transactions or events. (paragraph 4) |
| New Zealand | Assets 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 | Assets 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) ⁸ | An enterprise must recognize an economic resource as an asset in the financial statements when all of the following conditions are met: <ul style="list-style-type: none"> 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. |

⁸ 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.