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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**16 November 2006, London**
Project:	**Conceptual Framework**
Subject:	**Phase B: Elements: Definition of an Asset (Agenda Paper 3)**

Introduction

1. This paper continues discussion of the elements phase of the joint IASB/FASB Conceptual Framework project. In July 2006, the Boards considered a working draft definition of an asset and amplifying text for the Conceptual Framework. This paper considers issues arising in July and requests that the Boards approve the working definition of an asset. Such approval will provide a basis for use in moving forward with other aspects of Phase B of the Conceptual Framework project, including informal external consultation as agreed to in October 2006.

2. As with previous papers, this paper does not consider when an asset should be recognised. Recognition is a separate topic scheduled for discussion later in the project. Therefore, conclusions reached on what meets the definition of an asset do not necessarily mean that all assets (as defined) will be recognised in financial statements.[1] Further work on the unit of

[1] However, our preliminary thinking is that any recognition criteria most likely would be limited to practical considerations.

account also remains to be considered later in the project. However, we[2] think that the proposed working definition of an asset can provide some insights in that regard, by leading us to identify what it is that is capable of being used (either alone or together with other economic resources) to produce net cash inflows or reduce net cash outflows.

3. This paper sets out the proposed working definition of an asset. It then compares the proposed working definition of an asset with the existing IASB and FASB definitions and analyses the shortcomings of the existing definitions and discusses how the proposed working definition overcomes those shortcomings. Subsequently, the paper discusses changes made to the working definition of an asset since the Boards' last discussions in July 2006 and analyses issues arising during the July 2006 Boards' discussions and subsequent consultation with other groups and individuals. Finally, the paper includes a proposed draft of a possible definition of a liability that parallels that of an asset. While the definition of a liability will be a subject for discussion at future meetings, the draft definition demonstrates that it is possible to draft a mirror-image definition of a liability and to portray the liability arising when an asset gives rise to a corresponding liability of another party.

4. Appendix A to this paper sets out a working draft of the amplifying text that we propose would support the definition of an asset in a revised Conceptual Framework. Appendix B sets out existing definitions of the IASB, FASB, national accounting standards setters, and others for reference purposes.

5. After discussion, we will request that Board members approve the proposed working definition of an asset as a working draft for use in moving forward with other aspects of Phase B of the Conceptual Framework project. Comments on the working draft of the amplifying text are also welcome.

[2] "We" is used in this paper to refer to the 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.

Proposed Working Definition of an Asset

6. We propose the following working definition of an asset:[3]

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

a. An *economic resource* is something that has a net positive economic value because it is capable of being used (either alone or together with other economic resources) for carrying out activities such as production and exchange and, thus, producing net cash inflows or reducing net cash outflows (either directly or indirectly) without imposing a corresponding claim against the entity. Economic resources include contractual promises (other than those that are conditional) from others to the entity. Such promises include those to pay cash, deliver goods, or render services (rendering services includes standing-ready to perform and refraining from undertaking an activity that the promisor could otherwise undertake). As long as there is some capability of producing net cash inflows or reducing net cash outflows, there is an economic resource.

b. *A right or other privileged access* enables the entity to use the economic resource (either directly or indirectly) and to deny or limit use of it by others. *Rights* are a type of privileged access that comprise contractual rights and other rights that are legally enforceable or enforceable by equivalent means (such as by a professional association). Other privileged access is access that is neither legally enforceable nor enforceable by equivalent means.

c. *Present* means that the economic resource and the right or other privileged access to it exist on the date of the financial statements.

7. [Paragraph omitted from Observer Notes].

[3] The definition also is included on the final page of this paper, on the same page as the questions on which we seek the Boards' answers, so that Board members can detach that page and refer to it while reviewing the paper.

The Need to Change the Existing Definitions

8. Assets are the most fundamental real-world economic phenomena that financial reporting seeks to portray. If the definition of an asset is too vague or subject to interpretation, then the foundation of financial reporting is at risk of being undermined. Therefore, we think it is necessary that this definition be as robust as possible. The following paragraphs outline some of the shortfalls of the existing IASB and FASB definitions of an asset and explain how the proposed new definition seeks to mitigate these shortfalls.

9. The existing IASB and FASB definitions of an asset are as follows:[4]

> 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. [IASB Framework, paragraph 49]
>
> **Assets** are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [CON 6, paragraph 25; Footnote reference omitted.]

10. *Likelihood*—Likelihood ("expectation" in the case of the IASB and "probability" in the case of the FASB) was referred to in the existing definitions in response to constituents' concerns on earlier proposals that the definition would require that an item be certain in order to qualify as an asset. Since few things in life are certain, they observed that few items that are commonly thought to be assets would qualify in accordance with the definition. Accordingly, the Boards included likelihood with the intent of indicating that the item in question need not be certain (that is, it could be less than certain) to meet the definition.

11. Both the IASB and FASB definitions have been misinterpreted as implying that there must be a high expectation (IASB) or high probability (FASB) of future economic benefits before the definition is met. Thus, some think 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 in CON 6, which states:

> *probable* is used with its usual general meaning, rather than in a specific accounting or technical sense … and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither

[4] Existing definitions of other standard setters and others are included in Appendix B to this paper.

> certain nor proved.… Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain….[5]

12. To avoid this continued misinterpretation, the working definition does not depend on an assessment of likelihood. We think it is sufficient that the economic resource in question be capable of producing net cash inflows or reducing net cash outflows. 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.

13. *Future economic benefits*—This phrase, used in both the IASB and FASB definitions, focuses on identifying a future flow of economic benefits to demonstrate that an asset exists. We think that is the wrong focus. Financial statements can be viewed as reporting on things that exist (sometimes referred to as *stocks*) and changes in things that exist (sometimes referred to as *flows*). We think that the definition of an asset should focus on stocks—the things that are capable of producing net cash inflows or reducing net cash outflows. An asset is not an inflow, but rather an inflow is a consequence of it. The problem is that the existing FASB definition defines a 'stock' by reference to a 'flow.'

14. [Paragraph omitted from Observer Notes].

15. To avoid this misinterpretation, the working definition replaces *future economic benefits* with *present economic resources*. The use of *economic resources* rather than *economic benefits* indicates that the item is a stock, rather than a flow, and the use of *present* rather than *future* indicates that the item must presently exist.

16. *Past transaction or event*—[Sentence omitted from Observer Notes]. In applying both the IASB and FASB definitions, some people place undue emphasis on identifying the past transaction or event that gave rise to an asset. Though that identification might be helpful, it can be a distraction and lead to debates about which event is the triggering event instead of focusing on whether the economic resource and the access to it exist at the balance sheet date. How the economic resource and access to it were obtained does not affect whether

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[5] See CON 6, paragraph 25, footnote 18.

something under consideration meets the definition of an asset at the present time. Although an observed transaction or other event might provide a signal that an asset might be present and provide a clue as to its nature, the failure to observe such a transaction or other event does not demonstrate that an asset is not present. Conversely, just because a transaction or other event has occurred, that does not mean an asset has resulted from it. For example, expenditure could have resulted in an expense rather than an asset.

17. To avoid undue emphasis on seeking out a past transaction or event, the working definition focuses on what is necessary for 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 economic resource and access to it must exist today—so they cannot be economic resources or access that will not arise until the future or that existed in the past, but no longer exist at the balance sheet date.

18. *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. [Sentence omitted from Observer Notes].

19. We think that replacing the term "control" avoids the problem that the term can mean different things in different contexts. "Rights or other privileged access"—a term, derived from the UK *Statement of Principles for Financial Reporting* (UK SOP),[6] better reflects the manner in which an entity is associated with economic resources in today's complex business world. This term reflects both an entity's ability to use a particular resource and its ability to deny or limit others' use of the resource.

20. *Future net cash inflows*—The amplifying text to both the IASB and FASB definitions of an asset refer to assets as having the capacity, or potential, to contribute directly or indirectly to *the flow of cash and cash equivalents to the entity* (IASB), or *future net cash inflows* (FASB). It is not clear from the existing IASB text whether cash outflows that might be required to obtain future cash inflows, such as cash outflows associated with expenses incurred to

[6] Accounting Standards Board, *Statement of Principles for Financial Reporting*, October 1999.

generate cash inflows associated with revenues, should be taken into account in this assessment.

21. To clarify this, we propose to explain that producing net cash inflows, or reducing net cash outflows, should take into account necessary cash flows in the other direction. That is, in assessing whether something produces net cash inflows, one needs to take into account cash outflows that are necessary to produce the cash inflows. Thus, if something is capable of only being used in a manner that, while producing cash inflows, simultaneously results in equal or greater cash outflows, there is no economic resource and, thus, no asset.

22. *Contractual promises*—The amplifying texts supporting the existing IASB and FASB definitions are not clear regarding the application of the definitions to contractual promises. CON 6 suggests that contractual promises may be assets, but does not indicate which features might distinguish between those promises that are assets and those that are not. The IASB Framework is silent on this matter.

23. In developing the working definition, we have clarified that contractual promises can give rise to assets for the holder of the promise, and the circumstances in which they can do so (See paragraphs A10-A16 of this paper).

24. Question 1: *Do you agree that the proposed working definition of an asset overcomes shortcomings in the existing definitions, and thus, is an improvement?*

Changes Since July 2006

25. In July 2006, the Boards discussed the following definition and essential characteristics of an asset:

> 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.
>
> 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.

26. The only change that the staff proposes making to the first sentence of the definition of an asset is to refer to *the* entity rather than *an* entity, which will emphasise that the assessment is whether the entity in question has an asset, not whether any entity has an asset. This is consistent with the wording of the existing IASB definition.

27. [Paragraph omitted from Observer Notes].

28. The explanation of an *economic resource* starts by explaining that it is something that has a positive economic value. This is consistent with the Shorter Oxford English Dictionary definition of an asset as "a thing … of use or value."[7] It captures the idea that an economic resource is a thing of value. It is not necessarily a physical thing; it might be an intangible, including a contractual promise. This also helps focus on what is the thing that is of use or value—a focus that might help us in future consideration of the appropriate unit of account.

29. The term *economic value* is not clear enough on its own. Therefore, we explain that something is of *value* because "it is capable of being used for carrying out activities such as production and exchange." This draws on an existing explanation of economic resources in CON 6 as "scarce means that are useful for carrying out economic activities, such as consumption, production, and exchange." We think that the word "consumption" is not necessary. It does not add anything to "production and exchange". We deal with scarcity later in this paper, in the amplifying text.

30. We also explain what we mean by *economic* value. Economic value, as opposed to, say, sentimental value, relates to finances and is what financial statements seek to portray. Therefore, we explain that we are seeking those things that are capable of being used in "producing net cash inflows or reducing net cash outflows." We add that the thing that is capable of producing net cash inflows or reducing net cash outflows must not impose a

7 Oxford University Press, Fifth Edition (2002).

corresponding claim against the entity. This will clarify that an entity's own unissued or reacquired shares or debt are not economic resources.[8]

31. [Paragraph omitted from Observer Notes].

32. The explanation of the term *right or other privileged access* starts by explaining the broader term—privileged access—as being that which "enables the entity to use the economic resource and to deny or limit use of it by others." Then, the explanation explains the subset of privileged access—rights—and takes the opportunity, as suggested by some Board members in July, to introduce the explanation that rights are "enforceable" either by legal or by equivalent means.

33. The final part of the explanatory material explains what constitutes *present* and is essentially unchanged from that considered in July.

34. Question 2: *Do you agree with the changes made to the definition of an asset since July 2006?*

Other Matters Arising from July 2006 Board Discussions

35. The following paragraphs discuss matters raised during the July 2006 Board discussions that have not resulted in changes to the definition of an asset or its amplifying text.

36. *Economic*—Several individuals with whom we have discussed the working definition of an asset have questioned the use of the word *economic* as a qualifier to "resource" and the link to production of net cash inflows or reduction of net cash outflows. In particular, those considering the definition from a not-for-profit organization or public sector perspective question whether this is appropriate. They suggest that a broader reference is necessary that also encompasses the notion of service capacity—perhaps focusing only on the need for there to be a "resource" and that it is "something that is of value or of use to the entity." They note that "economic" is not used in recent definitions of an asset being developed by the Federal Accounting Standards Advisory Board and Governmental Accounting Standards Board in the

[8] This might be considered evident from the fact that "*net* positive economic value" is necessary in order to be an economic resource. However, at this stage of the project, we think that this is worth highlighting.

United States (see Appendix B to this paper). Some think that this issue also applies to private sector business entities that undertake activities that are not primarily for profit-generation, such as holding items for donation to charity, or for other causes that benefit society rather than for an entity's cash generation processes.

37. [Paragraph omitted from Observer Notes].

38. *Privileged*—Some are concerned with the use of the word "privileged." In particular, they note that the word is unfamiliar, or is not easy to translate. Some view a privilege as a "free right," in the sense that one can have privileges such as the privilege of free speech or free access to public parks. Others are concerned that the word does not translate easily into other languages. For example, in some languages the notion of a "privilege" does not exist, but the notion of a "right to exclude" does exist. Some have suggested referring to "unique" access, but as discussed in an earlier paper, this does not work well when access is shared with others (although nonetheless is restricted from all).

39. We have sought out alternative words, but have found none, at least in the English language, that better captures the idea we wish to express. The closest alternatives might be "advantageous" access or "restricted" access. However, we do not think these are as good as "privileged" access. Therefore, we propose to continue to use the word "privileged," but have included in part b. of the definition the explanation that privileged access "enables the entity to use the economic resource … and to deny or limit use of it by others."

40. *Present*—Some Board members questioned the use of the word "present" twice in the definition. A possible alternative suggested could be to replace the first use of the word by "existing." (Thus, we would refer to, "… an *existing* economic resource…")

41. We think that the use of "present" twice emphasises that both the economic resource and the right or other privileged access must exist at the date of the financial statements. We also think that "existing" can be read by some as implying that the economic resource must be something that physically exists, thus, excluding intangibles. Accordingly, we propose to retain the use of "present" twice in the definition.

42. *Order of thoughts in the definition*—Several Board members suggested reversing the definition such that it would say, “An asset is a present right or other privileged access to a present economic resource.”

43. We think it preferable to maintain the first focus on the economic resource. That is what constitutes the asset. It is the rights or other privileged access that associate the economic resource with the entity and makes the asset an asset of the entity. Furthermore, we note that *all* existing definitions of an asset, except that of the United Kingdom, (see Appendix B of this paper) focus first on the thing that is an asset and secondly on the entity’s association with that thing, so that structure is already familiar to constituents.

44. *Joint and several ownership*—Several Board members questioned the reference in paragraph 22 of the amplifying text to the July working draft definition to “joint and several ownership” as an exception to the statement that, “no asset can simultaneously be an asset of more than one entity.” We agree that this is not an exception and have removed this reference. The more relevant discussion is that in paragraph A25, which states that, “Two or more entities can have an interest held under the same title in a single economic resource, such as a parcel of land or mineral deposit. Each has a right to net cash inflows or a reduction in net cash outflows deriving from that interest that would qualify as an asset, even though the right of each is subject at least to some extent to the rights of the other entity (or entities).”

45. Question 3: *Do you agree with the disposition of these other matters arising from July 2006 Board discussions?*

46. Question 4: *Do you agree that the proposed working definition of an asset communicates more clearly and facilitates a more disciplined analysis than the existing definitions?*

47. Some have expressed concerns that the working definition of an asset might include or exclude things that they believe should not be included or excluded. We are interested in understanding more specifically what things Board members are concerned about in this regard—particularly if there are things that are being discussed in other accounting standards-setting projects of which the Conceptual Framework staff might not be aware.

48. Question 5: *Do you think that the proposed working definition would exclude things that should be assets? If so, what would be excluded, why do you believe that the definition excludes it, and why should the thing be included?*

49. Question 6: *Do you think that the proposed working definition would include things that should not be assets? If so, what would be included, why do you believe that the definition includes it, and why should the thing be excluded?*

50. Question 7: *Do you approve the proposed working definition of an asset as a working draft for use in moving forward with other aspects of Phase B of the Conceptual Framework project?*

Draft Definition of a Liability

51. The following draft definition of a liability is included for reference purposes only. Some have previously commented on aspects that are incorporated in this draft definition. We will continue to work on this definition and do not intend to discuss those aspects at this meeting. The definition of a liability is included solely to demonstrate that it is possible to draft a definition that is a mirror-image to the asset definition. The working definition of a liability will be discussed at a future date.

A liability is a present economic burden for which an entity has a present obligation.

a. An *economic burden* is something that has a net negative economic value because it is capable of requiring the sacrifice of economic resources and, thus, requiring net cash outflows or reducing net cash inflows (either directly or indirectly). Economic burdens include contractual promises (other than those that are conditional) to others by the entity. Such promises include those to pay cash, deliver goods, or render services (rendering services includes standing ready to perform or refraining from undertaking an activity the promisor could otherwise undertake). As long as there is some capability of requiring net cash outflows or reducing net cash inflows, there is an economic burden.

b. An *obligation* requires the entity to bear the economic burden. Obligations include contractual and other obligations that are legally enforceable or enforceable by equivalent means (such as by a professional association).

c. *Present* means that the economic burden and the obligation exist on the date of the financial statements.

APPENDIX A

Working Draft of Amplifying Text

Background

A1. Elements are the most basic of the real-world economic phenomena that pertain to an entity. Financial reporting seeks to portray information about those elements. The financial position of an entity at a point in time is comprised of those elements that exist at that point in time—stocks. Other statements portray changes in those elements—flows.

A2. Definitions of elements are a significant first screen in determining the content of financial reports. An item’s meeting the definition of an element is a necessary, but not a sufficient condition for recognising the item in an entity’s financial report. To be included in a particular financial report, an item must not only meet the definition of an element, but also must meet criteria for recognition and measurement.[9]

A3. All elements are defined in relation to a particular entity. An item that meets a definition of an element is a particular entity's asset, liability, revenue, expense, or so forth. Counter-parties to the entity are referred to as *others*, which include individuals, business entities, not-for-profit entities, and the like. For example, employees, suppliers, customers or beneficiaries, lenders, shareholders, donors, and governments are all *others* to a particular entity. A subsidiary company that is part of the same entity as its parent company in consolidated financial statements is an "other" in the separate financial statements of its parent. *Others* may be individuals or a class of persons.

Assets

An Economic Resource

A4. The definition of an asset requires that there be an economic resource—something that has a net positive economic value. An economic resource is not necessarily a physical thing; it might be an intangible, including a contractual promise.

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[9] Criteria for recognition and measurement will be considered later in this project.

Definition of an Asset

A5. Something is of *value* when it is capable of being used to meet the objectives of an entity through carrying out activities such as production and exchange. For financial reporting purposes, we are interested in those things that have *economic* value—that is, those things that are capable of producing net cash inflows to the entity or reducing net cash outflows from the entity. Thus, something that only has sentimental value—that is, it is incapable of having value to others—does not have *economic* value. Something that is available to all—that is, something that is not scarce—also does not have *economic* value.

A6. Cash flows can be direct or indirect, and can arise from a single resource or from a combination of resources. As explained in paragraph OB20 of Chapter 1: *The Objective of Financial Reporting*:

> Some of an entity's economic resources, such as accounts receivable or investments in debt instruments, are direct sources of future cash inflows.... However, many of the cash flows generated by an entity's operations result from combining several of its economic resources to produce or provide and market goods or services. Although those cash flows cannot be identified with individual economic resources…, investors and creditors need to know the nature and quantity of the resources available for use in an entity's operations….

A7. 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, including not only the resources that a buyer obtains individually but also the resources a buyer obtains in a purchase of several items at the same time (often referred to as a "basket" purchase) or in a business combination. 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 it is tangible or intangible and whether or not it has a market price or is otherwise exchangeable, is also an economic resource.

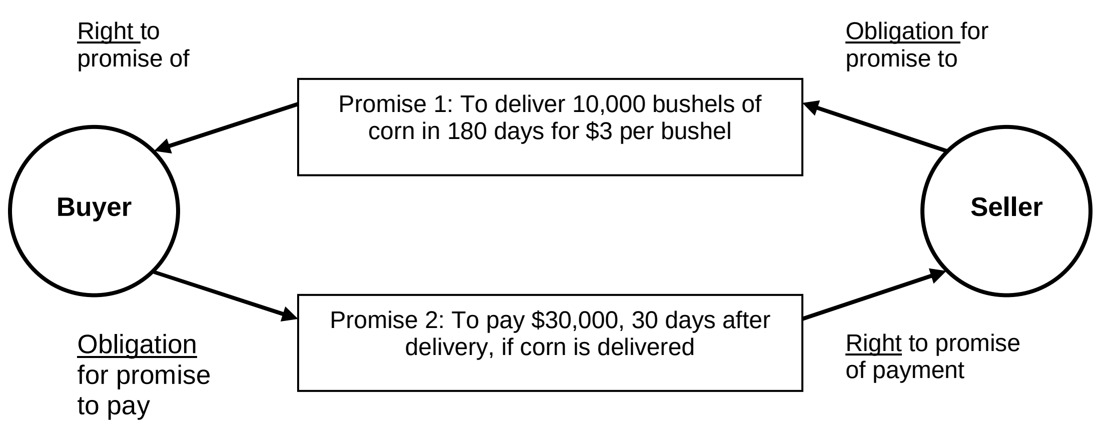
A8. In assessing whether something is capable of producing net cash inflows it is necessary to take into account cash outflows that are necessary to produce the cash inflows. Thus, if something is capable of being used only in a manner that produces cash inflows while simultaneously requiring equal or greater cash outflows, it is not an economic resource—and, therefore, it cannot be an asset. In addition, an entity's own unissued or reacquired shares or debt are not economic resources, since they impose a corresponding claim against the entity—there is no net positive economic value.

A9. Economic resources include, among other things: inventory, plant, equipment, mineral deposits, patents, goodwill, rights to receive services, cash, claims to cash, and ownership interests in other entities.

A10. An economic resource can result from contractual arrangements. In these circumstances, the economic resource is the contractual promise from another party if that promise is capable of producing net cash inflows or reducing net cash outflows and is not conditional. Contracts generally involve exchanges of promises—one party promises to do something in exchange for a promise from another party to do something else in return.

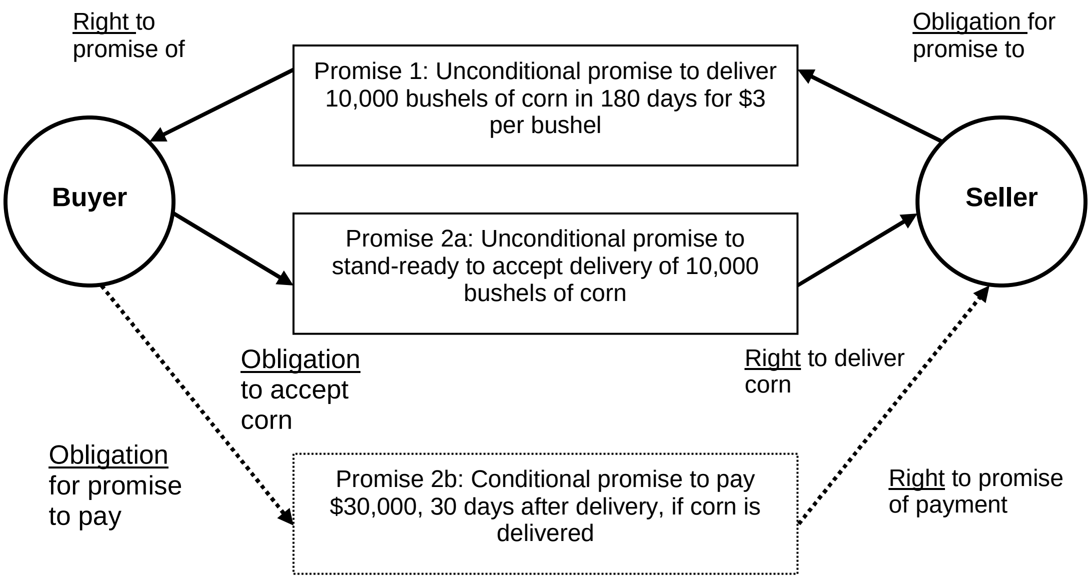
A11. For example, consider a contract for 10,000 bushels of corn to be delivered in 180 days at a fixed price of $3 per bushel to be paid 30 days after delivery. Figure 1 illustrates the stated contractual promises—a promise by the seller to deliver corn to the buyer (Promise 1) and a promise by the buyer to pay $30,000 to the seller 30 days after delivery, if the corn is delivered (Promise 2).

Figure 1: Stated Promises at Contract Inception



A12. However, the stated promises do not tell the whole story. Promise 2 comprises two related promises: 2(a), an unconditional promise by the buyer to stand ready to accept delivery of 10,000 bushels of corn from the seller at $3 per bushel and 2(b), a conditional promise by the buyer to pay $30,000 to the seller 30 days after delivery, if corn is delivered. These promises are illustrated in Figure 2.

Figure 2: Promises at Contract Inception



A13. Each of the unconditional promises is capable of producing net cash inflows and therefore can be economic resources. If the price of corn rises above the agreed-upon price of $3 per bushel (for example, if the supply of corn becomes limited), Promise 1 will increase in value, whereas if the price of corn falls below that price, Promise 2a will increase in value.

A14. In contrast, the conditional promise (Promise 2b) is not capable of producing net cash inflows until the condition is fulfilled. The conditional promise by the buyer to pay $30,000 to the seller if corn is delivered is dependent on the delivery of the corn, and the seller might not deliver corn. Therefore, Promise 2b does not have a net positive economic value to the seller and is not an economic resource.

A15. Until the seller’s promise to deliver corn is fulfilled, the buyer’s present economic resource is the seller’s contractual promise to deliver 10,000 bushels of corn in 180 days (Promise 1). The buyer’s economic resource is not the corn to be grown and harvested in the future (the seller may not yet have grown corn or have any corn on hand).

A16. When the seller delivers the corn, the seller's promise to deliver corn is fulfilled. The buyer's economic resource—the unconditional contractual promise (Promise 1)—is replaced by a new economic resource—10,000 bushels of corn—to which the buyer has property rights. At the same time, the conditional promise by the buyer to pay $30,000 to the seller (Promise 2b) becomes unconditional. After 30 days that unconditional promise will become mature.

A17. An entity that reacquires items such as its own debt, or franchise rights that it previously granted, does not acquire an economic resource, since there is no party external to the entity from which the entity can seek enforcement of the promise (i.e., there is no external obligor). Hence, the entity cannot have an asset (even though there was an asset for the selling party immediately prior to the reacquisition by the entity). Similarly, an unsigned contract has no counter-party and, hence, cannot be an economic resource or an asset.

Rights or Other Privileged Access to an Economic Resource

A18. The definition of an asset requires that the entity has rights or other privileged access to the economic resource. The assets that are useful for financial reporting purposes are those that are relevant to users' decisions about the entity. Therefore, the relevant economic resources are those *of the entity*. An entity establishes its ability to benefit from particular economic resources by having access to those resources. Access is what associates economic resources with the entity.

A19. Access that gives an entity no advantage beyond the common advantages of others because it is available to all does not result in an asset. Having a public road outside an entity's property might seem like an asset of that entity. However, as long as there are no restrictions as to who can drive on that road, access to it is not an asset of the entity (although the proximity of the road might add value to the entity's property)—the entity has no advantage, or "privileged access." However, a right to use a road, such as a right to drive a car on a toll road from which it might otherwise be excluded, can be an asset of an entity if it can lead to net cash inflows or a reduction in net cash outflows.

A20. Rights are the most common 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 if the original rights holder relinquishes its rights in favour of another party, which now has rights to that economic resource. For example, when inventory items are sold, the seller relinquishes its rights to the inventory item and the buyer obtains rights to the inventory item. The other party, the buyer, now has access to the economic resource. The economic resource itself might not have changed.

A21. An entity's association with economic resources can be represented by property rights (such as the right to possess, use, and enjoy a parcel of land), in which case there is no corresponding obligation of another party. However, for other rights, such as contractual rights another party must have a corresponding obligation and, thus, a liability. .

A22. An entity can demonstrate that it has rights in various ways. Often an entity has rights by virtue of ownership of an item. Such ownership usually gives the owner access to the various means of deriving net cash inflows or a reduction in net cash outflows from the economic resource, including by using and enjoying the resource, selling or exchanging it, or exploiting its value, such as by pledging it as security for borrowing.

A23. However, an entity can have legally enforceable rights to an economic resource without having ownership of the resource, as is the case with contractual rights. This occurs, 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 that provides rights to receive royalty payments from sales of a particular book or publication.

A24. Other legally enforceable rights to economic resources 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, statutory rights and property rights.

A25. Rights may be single (held solely by the entity) or shared (held in conjunction with others). Two or more entities can have different rights to economic resources arising from the same item at the same time, or can have rights to the same economic resource at different times. For example, a lease arrangement might give the lessee the right to an economic resource in the form of use of a property and the lessor the right to an economic resource in the form of rental receipts. Also, time-share property owners have the right to an economic resource in the form of use of a property during specified time periods. Each entity has an asset based on the rights that it has.

A26. Two or more entities can have an interest held under the same title in a single economic resource, such as a parcel of land or mineral deposit. Each has a right to net cash inflows or a reduction in net cash outflows deriving from that interest that would qualify as an asset, even though the right of each is subject at least to some extent to the rights of the other entity (or entities).

A27. Rights also can 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—for example, the right to issue assurance opinions on financial statements conferred on a qualified accountant by a professional accounting organization. If such rights are enforced similarly to how rights would be legally enforced (even though the consequences of enforcement might differ), they are regarded as the equivalent of legally enforceable rights.

A28. An entity also can produce net cash inflows or reduce net cash outflows in the absence of legally enforceable rights. For example, an entity might have no legally enforceable right to secret know-how, or an unpatented invention, but can use or sell the knowledge or invention (to produce net cash inflows) and deny or limit others' access to it. Therefore, the ability to access an item and to deny or limit others' access also creates an asset of the entity in that it creates an advantage beyond the common advantages of others (that is, privileged access).

A29. 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: (a) relinquish those rights or permit access, (b) use the resource to produce goods or services or reduce other expenditures, (c) exact a price for others' use of the economic resource, (d) transfer the economic resource in settlement of liabilities, or (e) distribute the economic resource to its owners.

A30. 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 only produces net cash inflows or a reduction in net cash outflows that accrue to another entity. For example, an entity that is acting in a fiduciary capacity, as a trustee, does not 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

A31. Rights (or other privileged access) better express the association of an entity with economic resources than control. 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). However, what is important in associating an entity with 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 itself an economic resource. 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 its 10 percent interest. The same applies for assets that are associated with an entity other than by means of property rights. The role of control 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.

A32. Another party’s restriction that also happens to 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 competes against team B and would prefer that the player not be traded to team B. However, team C has no right to that economic resource (the restriction) as it does not direct, manage, or have power over the restriction. Hence, team C does not have an asset as defined.

Present at the Financial Statement Date

A33. The definition of an asset requires that the economic resource and the right or other privileged access to it both exist at the financial statement date. Thus, the entity must have *present* rights or other privileged access to a *present* economic resource. This means that the asset must have arisen from past transactions or other past events. Often an entity obtains assets by purchasing or producing them, but other transactions or events may give rise to assets. Examples include, signing a contract with another party, discovering mineral deposits and receiving 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 privileged access does not affect whether something meets the definition of an asset at the present time (that is, the history of how the asset arose, or of how the entity obtained the asset, does not matter), although it might provide evidence to help in the assessment as to whether the entity has an asset.

A34. Expected future transactions or other events are not assets today. An intention to purchase inventory does not meet the definition of an asset. Equipment that an entity plans to acquire next year does not give rise to a present right to that equipment today.

A35. The corollary is that an entity has an asset if the transactions or other events that ultimately transfer, use up, or destroy the economic benefits associated with the resource will occur in the future. For example, a building is an entity's asset even if the entity has decided that it will sell or stop using the building in a year.

A36. Both the rights or other privileged access and the economic resource must exist. If rights have been relinquished, but the economic resource still exists, then the entity no longer has an asset. Conversely, 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 dissolved), the entity no longer has an asset.

APPENDIX B

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[10]	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. (page 19)
FASAB[11]	An **asset** is a resource that embodies economic benefits or services that the federal government can control. (paragraph 17)
GASB[12]	**Assets** are resources that the entity presently controls.

[10] *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.

[11] Federal Accounting Standards Advisory Board, July 2006 Exposure Draft, *Proposed Statement of Federal Financial Accounting Concepts: Definition and Recognition of Elements of Accrual-Basis Financial Statements.*

[12] Governmental Accounting Standards Board, August 2006 Exposure Draft, *Proposed Statement of Governmental Accounting Standards Board on concepts related to Elements of Financial Statements.*

SUMMARY

Proposed Working Definition of an Asset

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

a. An *economic resource* is something that has a net positive economic value because it is capable of being used (either alone or together with other economic resources) for carrying out activities such as production and exchange and, thus, producing net cash inflows, or reducing net cash outflows (either directly or indirectly) without imposing a corresponding claim against the entity. Economic resources include contractual promises (other than those that are conditional) from others to the entity. Such promises include those to pay cash, deliver goods, or render services (rendering services includes standing-ready to perform and refraining from undertaking an activity that the promisor could otherwise undertake). As long as there is some capability of producing net cash inflows or reducing net cash outflows, there is an economic resource.

b. *A right or other privileged access* enables the entity to use the economic resource (either directly or indirectly) and to deny or limit use of it by others. *Rights* are a type of privileged access that comprise contractual rights and other rights that are legally enforceable or enforceable by equivalent means (such as by a professional association). Other privileged access is access that is neither legally enforceable nor enforceable by equivalent means.

c. *Present* means that the economic resource and the right or other privileged access to it exist on the date of the financial statements.

Questions for the Boards

Q1: Do you agree that the proposed working definition of an asset overcomes shortcomings in the existing definitions, and thus, is an improvement? (See paragraph 24)

Q2: Do you agree with the changes made to the definition of an asset since July 2006? (See paragraph 34)

Q3: Do you agree with the disposition of other matters arising from the July 2006 Board discussions? (See paragraph 45)

Q4: Do you agree that the proposed working definition of an asset communicates more clearly and facilitates a more disciplined analysis than the existing definitions? (See paragraph 46)

Q5: Do you think that the proposed working definition would exclude things that should be assets? If so, why do you believe that the definition excludes it, and why should the thing be included? (See paragraph 48)

Q6: Do you think that the proposed working definition would include things that should not be assets? If so, what would be included, why do you believe that the definition includes it, and why should the thing be excluded? (See paragraph 49)

Q7: Do you approve the proposed working definition of an asset as a working draft for use in moving forward with other aspects of Phase B of the Conceptual Framework project? (See paragraph 50)