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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

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Project:	**Conceptual Framework**
Subject:	**Phase B: Elements and Recognition – Asset Definition Converging and Improving the Definition (Agenda Paper 16C)**

Introduction

1. In describing the IASB/FASB Conceptual Framework project, the IASB and FASB websites state that the objective of the project is:

> "to develop a common conceptual framework that is both complete and internally consistent. Such a framework would provide a sound foundation for developing future accounting standards and is essential to fulfilling the Boards' goal of developing standards that are principles-based, internally consistent, internationally converged, and that lead to financial reporting that provides the information needed for investment, credit, and similar decisions. That framework, which will deal with a wide range of issues, will build on the existing IASB and FASB frameworks and consider developments since they issued their original frameworks.

Two important aspects of this objective are that the result will be a single "common conceptual framework" and that it will "build on the existing IASB and FASB frameworks." In short, these two parts of the objective might be referred to as to *converge* and *improve* the existing frameworks.

2. A constant consideration in many joint standards-setting projects, including the conceptual framework project, is how we should balance the need to *converge* with the desire to *improve*. In many, but not all, cases, it is possible to *converge* by selecting the best of each of two existing sets of standards and putting those pieces together. However, the extent to which we can, or should, *improve* is a matter of judgment. Because of its underlying importance to standards, the Conceptual Framework is more fundamental than individual standards, and for that reason, merely converging might not be enough.

3. This paper considers our work to date on the definition of an asset, including our previous work to develop a proposed working definition (see Appendix A) in terms of *convergence* and *improvement*. It evaluates the extent to which we can merely *converge* the existing IASB and FASB definitions of an asset, as well as the extent to which we might seek to *improve* them. First, the paper considers what might be necessary for mere convergence. It then proceeds to consider possible additional improvements that might be made to the definition and requests Board members' decisions on a working definition of an asset for use as we proceed with other aspects of Phase B of the conceptual framework project.

4. This paper considers the *definition* of an asset only—that is, it considers whether an asset exists and whether it is the entity's asset. It does not consider whether an asset should be *recognised*. The purpose of recognition is to decide which things should be included on an entity's balance sheet. These might exclude things that meet the definition of an asset, but for which there are other reasons for non-recognition.

5. In some cases, there might be uncertainty as to whether the definition of an asset is met. That is, there might be uncertainty about whether an asset exists, or whether it is the entity's asset. In these cases, a decision as to whether to recognise something on the balance sheet will be necessary. We plan to consider situations involving uncertainty at a later date in Phase B of the Conceptual Framework project.

6. Also, we think that there might be other practical reasons for non-recognition. For example, the asset might be immaterial or it is not possible to assign a number to the asset (inability to measure). *If Board members think that there are other reasons why some things that meet the definition of an asset should not be recognised on the balance sheet, they are asked to*

raise them as part of this discussion, as well as to consider how the definition might need to be modified to take account of such reasons.

7. In considering reasons for non-recognition of things that meet the definition of an asset, care should be taken to bear in mind that the conceptual framework needs to be sufficiently broad that it can stand the test of time. *Standards* at a point in time might deal with practicalities associated with applying the framework to specific circumstances—such as specifying that a particular type of asset is insufficiently capable of measurement to be recognised for financial reporting purposes. However, that should not be the job of the Framework. For example, IAS 38, Intangible Assets, currently specifies that, "internally generated goodwill shall not be recognised as an asset" (see paragraph 48). IAS 38, paragraph 49 goes on to explain, in part, that "internally generated goodwill is not recognised as an asset because it is not an identifiable resource." This might suggest that a key characteristic of an asset is that it is identifiable (described in IAS 38 as separable or arising from contractual or other legal rights). However, we think that whether something is identifiable is a practical consideration that might be considered in assessing whether to *recognise* something as an asset, but does not affect something's *existence* as an asset—that is, something can exist, even though it cannot be identified.

8. Some of the material in this paper is based on material in the July 2007 Board paper, which identifies the aspects of the existing IASB and FASB asset definitions that have shortcomings and how those shortcomings might be overcome. The material is, however, refocused and developed further to consider alternative means of overcoming certain shortcomings. In particular, the latter part of the paper considers, further, the role of control.

Summary

9. The main issue to be resolved in order to *converge* the existing IASB and FASB definitions is to decide whether the definition should focus on defining an asset as an *economic resource* or as *probable future economic benefits*. We think it better to focus on an *economic resource*. This is discussed in paragraphs 14-25.

10. We also think it preferable to *improve* the definitions by eliminating any reference to *likelihood* (see paragraphs 26-35) and replacing references to *past events* or *past transactions or events* with a focus on the *present* (see paragraphs 36-43). While neither of these proposed changes is essential for convergence, we think that they are worthwhile improvements to the definition, which have been supported in consultations to date.

11. Additionally, we discuss the possibility of further improving the definition by replacing *control* as the linkage between the entity and the asset (see paragraphs 44-81). The proposed working definition suggested replacing *control* with *rights or other privileged access*. This proposal has received insufficient support in consultations. Therefore, we explore several other alternative approaches to improving this aspect of the definition.

12. Finally, we consider two alternative amendments to the definition of an asset:

    a. Focus first on an entity's present rights, rather than on a present economic resource.

    b. Deal with the link between the entity and the economic resource as separate definition and recognition issues.

    (see paragraphs 82-92)

13. We ask the Boards to confirm the extent to which they wish to improve, as well as converge, the existing definitions of an asset and to settle on a working definition of an asset.

Converging the Definitions

14. The existing IASB and FASB definitions of an asset are as follows:[1]

> 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.]

[1] Appendix B to this paper shows existing definitions of others that the Boards and their staff have considered.

15. The existing definitions differ from one another. Therefore, at a minimum, some change is necessary to achieve convergence. There are several wording differences between the definitions, but the key difference is that the IASB definition focuses on an asset as being a *resource … from which future expected economic benefits are expected to flow to the entity* (the words, *from which future expected economic benefits are expected to flow to the entity*, qualify the word *resource* so that it is an *economic* resource), whereas the FASB definition focuses on an asset as being *probable future economic benefits*.

16. Even though the definition in FASB Concepts Statement No. 6 (CON 6) focuses on probable future economic benefits, paragraph 27 of the amplifying text introduces ambiguity by stating that, "The kinds of items that qualify as assets under the definition … are also commonly called economic resources." Paragraph 28 goes on to state that, "The common characteristic possessed by all assets (*economic resources*) is "*service potential*" or "future economic benefit," the *scarce capacity* to provide services or benefits to entities that use them." The italicized words seem to treat economic resources (present items) and economic benefits (future items) interchangeably. The existing IASB definition avoids this, focussing only on the (economic) *resource*.

17. We think that focusing on the economic resource as being the asset is the correct focus. Financial statements can be viewed as reporting on things that exist (sometimes referred to as *stocks*) and changes in those things (sometimes referred to as *flows*). We think that the definition of an asset should focus on stocks—the things, both tangible and intangible, that are capable of producing cash inflows or reducing cash outflows. An asset is not itself an inflow, but rather it is something that is capable of producing an inflow (or of reducing an outflow). The problem with the existing FASB definition is that it defines a 'stock' by reference to a 'flow.' (That is, it states that, "Assets are probable future economic benefits …".) The existing IASB definition does not have this problem.

18. It is also notable that definitions of an asset used by national standards setters in Canada, Germany and Japan, as well as definitions recently proposed or adopted by the CFA Institute, FASAB and GASB focus on the *resource* as the asset (see Appendix B). Indeed, they either refer to an *economic* resource or qualify or explain the word *resource* in such a way that it

means *economic* resource. In contrast, the Australian and New Zealand definitions focus on *future economic benefits*[2] and the UK definition focuses on *rights or other access to future economic benefits*.

19. [Paragraph omitted from Observer Notes.]

20. The proposed working definition of an asset developed previously (see Appendix A) deals with these problems by replacing *future economic benefits* in the FASB's existing definition with *a present economic resource*. The use of *economic resource* rather than *economic benefits* indicates that the focus is on a stock, rather than on a flow, and the use of *present* rather than *future* indicates that the resource must presently exist. (As noted earlier, the existing IASB definition focuses already on the asset as being a (economic) *resource*.) The amplifying text to the proposed working definition explains that an *economic resource* is, "something that has positive economic value. It is scarce and capable of being used to carry out economic activities such as production and exchange. It can contribute to producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources."

21. There was support for this change in emphasis from those with whom we consulted on the proposed working definition from December 2006 to March 2007.

22. By making this change we could converge the definitions of an asset by defining an asset as follows:

> "An *asset* is a present economic resource controlled by the entity as a result of past [transactions or] events from which future economic benefits are expected to flow to the entity."

23. This places the emphasis on an asset being an economic resource, while minimising other wording changes from the existing definitions. (Appropriate amplifying text would continue to explain key aspects of the definition.) Some might think this approach to be preferable, so as to maintain as much as possible of the definitions with which constituents are familiar.

[2] The New Zealand definition also focuses on service potential, which is a stock, rather than a flow.

24. *Do you agree that, as a minimum, the focus of the definition of an asset should be on a present economic resource rather than on future economic benefits? If not, why not?*

25. *Do you think that any further improvement should be considered (see below), or do you think that we should stop here?*

Further Improving the Definition

Likelihood

26. Both of the existing IASB and FASB definitions of an asset make reference to likelihood, but using different words ("expected" in the case of the IASB and "probable" in the case of the FASB). Likelihood was included in the existing FASB definition 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, the FASB observed that few items that are commonly thought to be assets would qualify in accordance with the definition. Accordingly, the FASB 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. We think that similar reasons resulted in the inclusion of *expected* in the IASB definition.

27. Both the IASB and FASB definitions have been misinterpreted as implying that there must be a high likelihood of future economic benefits for the definition to be met. [Phrase omitted from Observer Notes] some think that unless there is a high likelihood of future economic benefits, the asset definition is not met. That is not the intent. (A footnote to the FASB Definition in CON 6, paragraph 25, footnote 18, attempts to explain that, but seemingly has not been effective.) [Sentence omitted from Observer Notes.]

28. To avoid this continued misinterpretation, the proposed working definition of an asset clarifies that it does not depend on an assessment of a degree of likelihood. It states only that an economic resource must be *capable of producing cash inflows or reducing cash outflows.* If there is any question of likelihood to be considered, that might be a factor in assessing whether a particular asset (or asset class) qualifies for recognition or in determining its

measurement, not in the definition of an asset. (Recognition will be considered later in Phase B of the conceptual framework project and measurement is being considered in Phase C.)

29. This was the most favoured improvement in the proposed working definition when we consulted on the definition from December 2006 to March 2007.

30. This suggests that we should further amend the converged definition of an asset, in paragraph 22, above, as follows:

> "An *asset* is a present economic resource controlled by the entity as a result of past [transactions or] events that is capable of producing cash inflows or reducing cash outflows ~~from which future economic benefits are expected to flow to the entity~~."

31. *Do you agree that any assessment of likelihood should be removed from the definition of an asset? If not, why not?*

32. The phrase *that is capable of producing cash inflows or reducing cash outflows* is an incomplete description of what constitutes an economic resource. Also, it is not clear whether the phrase constitutes further explanation of what is an economic resource, or is a narrowing of that term to a particular type of economic resource. We think that the intent is the former and, therefore, that it is clearer not to include the phrase in the definition. Rather, we think it preferable to accompany the definition with a separate definition of an *economic resource*. Thus, the definition of an asset becomes:

> "An *asset* is a present economic resource ~~that is capable of producing cash inflows or reducing cash outflows,~~ controlled by the entity as a result of past [transactions or] events."

33. This would be accompanied by a definition of an economic resource as follows:

> "An *economic resource* is something that ~~has positive economic value. It~~ is scarce and capable of ~~being used to carry out economic activities such as production and exchange. It can contribute to~~ producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources."

The mark-up illustrates how we might change that from the definition of an economic resource in the proposed working definition of an asset, based on comments from the consultation.

34. We note that we could maintain greater similarity to the existing definitions of an asset by using the words, *capable of producing <u>future economic benefits</u>*, rather than *capable of producing <u>cash inflows or reducing cash outflows</u>*. However, we note that 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). We think that it is preferable to focus directly on the capability of producing cash inflows or reducing cash outflows.

35. Also, we note that, in assessing whether something is capable of producing 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. (A unit of account issue arises regarding how to present such an asset. Thus, for example, a customer contract asset might be presented in a manner that represents only the extent to which cash inflows exceed the necessary cash outflows to produce those cash inflows. Unit of account issues will be considered later in Phase B of the conceptual framework project)

Past Transaction or Event

36. Both the existing IASB and FASB definitions refer to the need for an asset to have arisen as a result of something having happened in the past. We think that references to “past event” (IASB), or “past transactions or events” (FASB), were included in the definitions primarily to exclude future assets from meeting the definition. However, in applying both the IASB and FASB definitions, some place undue emphasis on identifying the past transaction or other event that gave rise to an asset. For example, some have difficulty identifying the past transaction or other event giving rise to some intangible assets and, hence, conclude that there is no asset, even though an economic resource exists at the balance sheet date. [Sentence omitted from Observer Notes.]

37. Identification of a past transaction or other event can be a distraction and lead to debates about which event is the triggering event instead of focusing on whether the economic resource exists at the balance sheet date. How the economic resource arose does not affect whether it presently meets the definition of an asset. 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, a cash outflow could have been a loss or an expense, or could have been made to settle a liability rather than to obtain or create an asset.

38. To avoid undue emphasis on seeking out a past transaction or event, the proposed working definition of an asset focuses on what is necessary for an asset to exist 'at the present' (i.e., a *present* economic resource, to which the entity has a *present* right or other privileged access). By focusing on a present economic resource, and a present link to the entity, it becomes redundant to refer to the need for a past event. This also has the advantage that the economic resource and the link to the entity must exist today—so it cannot be an economic resource or a link that will not arise until the future or that existed in the past, but no longer exists at the financial statement date. Also, it is a more economical use of words—and historically, the Boards have preferred shorter definitions.

39. To the extent a past transaction or event might help to identify the existence of an asset, the amplifying text to the proposed working definition of an asset explains that being aware of the event or transaction is a sufficient but not a necessary condition.

40. There was support for this change from those with whom we consulted on the proposed working definition from December 2006 to March 2007.

41. This suggests that we should further amend the definition of an asset, in paragraph 32 above, as follows:

> "An *asset* is a present economic resource <u>presently</u> controlled by the entity ~~as a result of past [transactions or] events~~."

42. *Do you agree that a focus on the present is preferable to focussing on past transactions or events?*[3] *If not, why not?*

43. *Do you think that any further improvements should be considered (see below), or do you think that we should stop here?*

Control

44. An additional aspect of the definition that we might seek to address is what is meant by *control*. *Control* is used in both the existing IASB and FASB definitions of an asset. Indeed, all existing definitions of an asset that we have consulted include *control* to link the resource or economic benefits to the entity (see Appendix B). However, it is a term that is not always interpreted consistently [Phrase omitted from Observer Notes].

45. We think that it is worth considering whether we can improve on the use of the term *control*. Accordingly, the following paragraphs consider:

    a. How the proposed working definition of an asset attempts to deal with the issue, including some alternatives suggested during consultation on the proposed working definition.

    b. What do we mean by *control* in the definition of an asset—does its meaning in the definition of an asset differ from its meaning elsewhere in accounting standards?

The Proposed Working Definition of an Asset

46. The proposed working definition of an asset attempts to deal with the entity's link to the economic resource by replacing *control* with the phrase *rights or other privileged access*. We considered that phrase to better reflect the manner in which an entity is associated with an economic resource than *control*. Also, we think, by focusing on rights or other privileged access to the economic resource, that it reflects that the entity has rights or other access to any cash inflows or reduction of cash outflows that are capable of being produced by the

[3] If we do not delete *past transactions or events*, we should refer to *past transactions or* other *events*, since transactions are, themselves, events.

economic resource, rather than that the entity necessarily controls (or can influence) whether cash inflows or reduction of cash outflows will occur.

47. The amplifying text to the proposed working definition explains that rights are the most common mechanism that society uses to distinguish who has access to specific resources (i.e., to distinguish who is linked to a resource). Rights can be legally enforceable, but can also be enforceable by other equivalent means, such as those arising within a self-regulatory structure such as a professional organization. An example is the right to practice as an accountant, when that right is conferred on a qualified individual or firm 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 somewhat), they are regarded as the equivalent of legally enforceable rights.

48. The term *other privileged access* in the proposed working definition indicates not only that rights include more than legal rights, but also excludes from the definition access that is generally available. For example, an entity might have no enforceable right to secret know-how, or an unpatented invention, but secrecy protects the entity from others accessing the know-how or invention. Similarly, economic barriers might keep customers tied to an entity or keep competitors away, even though the entity has no enforceable rights. This is the case, for example, when customers would have to incur costs that exceed the benefits of switching to a competitor's services, or when there are significant barriers to market entry. The preclusion or limitation of access by others to an economic resource also demonstrates an entity's association with that economic resource—it demonstrates the existence of *privileged access*.

49. This aspect of the proposed working definition received least support from those with whom we consulted from December 2006 to March 2007. Some suggested that it might be better to explain how the term "control" should be used, rather than replace the term. Others struggled with whether "rights or other privileged access" is a clearer term than "control," noting, in particular, that *privileged access* is an unfamiliar term that does not translate well into many languages other than English.

50. It is clear that this proposed improvement has been the most troublesome and has not gained sufficient support from Board members or those consulted on the working definition. Accordingly, we explore alternative approaches, below.

51. Three alternatives were suggested by some of those with whom we consulted on the proposed working definition. These were as follows:

Alternative 1: Describe the link between the entity and the economic resource as the entity's *right*

Alternative 2: Describe the link between the entity and the economic resource as the entity's *access*

Alternative 3: Describe the link between the entity and the economic resource by describing the resource as being *of the entity*

52. **Alternative 1**—Several of those consulted on the proposed working definition from December 2006 to March 2007 suggested that, rather than referring to *rights or other privileged access*, we should refer only to *rights*, and explain that concept in the amplifying text in terms that include the ideas of *other privileged access*, but without using that terminology. Thus, the definition in paragraph 41, above, would become:

> "An *asset* is a present economic resource <u>to which</u> ~~presently controlled by~~ the entity <u>has a present *right*</u>." (emphasis added)

This would reduce the difficulties of understanding what *privileged access* means, as well as the translation difficulty. It would also allow for more explanation that rights can constitute more than those that are legally enforceable and would make the proposed working definition of a liability more parallel since that does not contain an equivalent to other privileged access.

53. A difficulty with this alternative is that those who do not study the amplifying text might overlook the explanation as to what constitutes *rights* and assume that it is restricted to those that are legally enforceable. That would be narrower than what we think the Boards intend the asset definition to be.

54. **Alternative 2—**An alternative, suggested by some, would be to refer to “access” as the generic term and explain that access comprises both rights and other privileged access. Thus, the definition in paragraph 41, above, would become:

> “An *asset* is a present economic resource to which ~~presently controlled by~~ the entity has present *access*.” (emphasis added)

Although this alternative has similar benefits to alternative 1, it seems to suffer a similar drawback, in that those who do not study the amplifying text might overlook the explanation as to what constitutes *access*. This might lead some to assume a broader definition than is intended.

55. **Alternative 3—**We could decide not to use any term to describe the manner in which the economic resource is linked to the entity. That is, the definition in paragraph 41, above, would become:

> “An *asset* is a present economic resource ~~presently controlled by~~ of the entity.” (emphasis added)

This has the advantage that it avoids having readers of the definition struggle with any of the terms *rights*, *privileged access*, *access*, or *control* and avoids difficulties that arise when we attempt to include new ideas in the definition using words that either stretch their common meaning, or require additional explanation to understand their meaning. Instead, readers would refer to the amplifying text, where the notions that we are trying to convey could be explained in more words.

56. A major disadvantage of this approach is that readers might not refer to the amplifying text, rather ascribing their own meanings to “of the entity”. We presented this definition as a staff recommendation in April 2006, along with several other alternatives. At that time, several Board members considered this definition too brief and thought that more clarity was necessary in the definition itself.

57. We think that none of the above three alternatives are clearly better than the proposed working definition. In each case, rather than clarifying what we mean in the definition, they leave that clarification to the amplifying text. Perhaps the one advantage that they have over retaining the word *control* is that it is difficult to change peoples’ understanding of a term

that they think they already understand, however much we might try to do that in amplifying text. (For example, in Phase A of the Conceptual Framework project the Boards concluded that we could not overcome peoples' misconceptions regarding the term *reliability* and chose instead to replace it with the more precise term, *faithful representation*.) By using a different word, we might enhance the chance that people will focus on the amplifying text to appropriately understand that new word.

58. We think, however, that if we are to improve this aspect of the definition, we should try to focus on clarifying the more fundamental questions of what it is that is controlled and what we mean by control in the definition of an asset. The next section of this paper explores those questions.

What Do We Mean By Control in the Definition of an Asset?

59. The single-sentence IASB definition of an asset focuses on a *resource controlled by the entity* and the FASB definition focuses on *probable future economic benefits controlled by the entity*. Of other definitions we have consulted (see Appendix B), the Canadian, German, Japanese, FASAB and GASB definitions focus on *resource*s *controlled by the entity*, while the Australian and New Zealand definitions focus on *future economic benefits controlled by the entity*.[4] The UK and CFA Institute definitions focus on *rights [or other access] to future economic benefits controlled by the entity*.

60. Even though the words of the IASB definition of an asset focus on *a resource controlled by the entity*, paragraph 57 of the amplifying text discusses *control of benefits* by stating that, "property held on a lease is an asset if *the entity controls the benefits* which are expected to flow from the property" (emphasis added) and stating that, "by keeping … know-how secret, *an entity controls the benefits* that are expected to flow from it" (emphasis added). Thus, it is not clear whether control applies to the resource, or to the ultimate benefits that the resource produces, or both.

[4] The New Zealand definition also focuses on control of service potential, which is more like a resource than future economic benefits.

61. Similarly, the amplifying text to the FASB definition, in CON 6, paragraph 26(a), equates probable future benefits with the *capacity* to contribute to net cash inflows (an economic resource) and CON 6, paragraph 27 states that, "The kinds of items that qualify as assets under the definition in paragraph 25 are also commonly called *economic resources*." Thus, in accordance with the FASB definition, it is also not clear whether control applies to the economic resource, or to the future economic benefits, or both.

62. We think that there are three things that could be controlled. A simple example of a fruit tree that is capable of bearing fruit that can be sold for cash illustrates the possibilities. :
    a. The fruit tree.
    b. The tree's capability of bearing fruit.
    c. Any fruit that the tree bears that can be sold for cash.

63. Because it is capable of bearing fruit that can be sold for cash, the fruit tree is capable of producing cash inflows indirectly and, therefore, is an *economic resource* (moreover, because of its fruit-and-cash-producing capability, the tree itself presumably could be sold for cash directly, which also indicates that it is an economic resource). The tree's capability of producing cash inflows, either directly or indirectly, is a *key characteristic* of an economic resource. The cash inflows that the tree can produce are the *output* or "*dividend*" that the economic resource produces, and are the ultimate objective of business activities by business entities.

64. Turning now to the matter of what is controlled, the entity that owns the tree controls not only the *economic resource* (by virtue of its ownership rights), but also controls *the capacity* of the economic resource to produce dividends, as well as the *dividends* themselves, if any, that the tree produces (assuming the entity has not separately entered into a contract to pass those dividends to others). However, the entity does <u>not</u> control *whether* the tree will ultimately bear any fruit because fruit-bearing is a natural process that is beyond the entity's control. While the entity can take steps to protect the tree and stimulate its production of fruit, in the end, whether the tree produces fruit is beyond the entity's control. That is, the entity has the ability to obtain fruit (which can produce cash inflows) from the tree (the economic resource), but the entity itself cannot cause there to be any fruit.

65. Alternatively, the entity that owns the fruit tree might enter into a contract with a second entity in which the second entity is entitled to the fruit that the tree produces, which that entity can then sell for cash. In that case, the second entity controls the *output* or *dividend* from the tree, but does not control the tree itself or its capacity to produce fruit. Instead, the second entity controls its contractual promise from the owner of the tree that entitles it to any fruit that the tree produces; that promise is the second entity's *economic resource,* and the *key characteristic* of that resource is the entity's entitlement to any fruit that the tree produces (which, in turn, can produce cash inflows). Again, the entity has the ability to obtain fruit (which can produce cash inflows) as a result of the contractual promise (the economic resource), but it cannot cause there to be any fruit.

66. These examples suggest that *control* might not be the best word to use to describe an entity's link to resources, economic benefits or rights to economic benefits, because that seems to imply to some that the entity can control whether there will be any fruit.

67. Considering what we mean by control, in applying the existing definitions, some view *control* as being used in the same sense as that presently used for purposes of consolidation accounting. For example, the definition of control in IAS 27, Consolidated and Separate Financial Statements, is "Control is the *power* to govern the financial and operating policies of an entity so as *to obtain benefits* from its activities" (emphasis added). That leads one to think of control as *the power to obtain benefits*. That is consistent with the manner in which control is discussed in the reporting entity phase of the joint conceptual framework project, in which the Boards have concluded that the definition of control should contain both a power element and a benefits element, together with a link between the two. We think that differs from the manner in which *control* is used in the definition of an asset.

68. In many examples involving the definition of an asset, an entity will have power, as well as the ability to obtain cash inflows. For example, in the case of some economic resources owned by an entity, the entity has the power to cause cash inflows to arise from those resources. However, in other examples, as illustrated in the fruit tree example, above, the entity need not have the power to cause the cash inflows to arise (That is, while the power criterion is *a sufficient condition*, it is not a *necessary condition*).

69. Other examples in Agenda Paper 16B/FASB Memorandum 66B illustrate this point. In the case of contractual rights to future music revenues from future recordings (example 14A) we think that the entity has an asset, even though it might have no power to require that future recordings be made or, if made, to require customers to buy those recordings. So long as future recordings are made and copies sold, the entity will get cash inflows from them. In the case of established customer relationships (example 13), an entity does not have the power to force its existing customers to continue to do business with the entity—but, if they do, then the entity can obtain future cash inflows. The entity has an asset resulting from the existing relationship between the entity and the customer that can result in future cash inflows, to the entity. Similarly, in the case of an assembled workforce (example 11) the entity cannot force its workers to continue to work for the entity, but it can obtain future cash inflows (or reduce future cash outflows) as a result of the relationship between it and the workforce.

70. In the existing FASB definition (and others), which focuses on control of probable future economic benefits, this can be particularly problematic if those benefits are viewed as being the outputs or dividends from the asset. This is because, in the examples in the previous paragraph, the entity does not have the *power* to cause there to be future cash inflows—however, the entity will get cash inflows if there are any. [Sentence omitted from Observer Notes.]

71. We think that it is sufficient that the entity can obtain cash inflows (or reduce cash outflows) from the economic resource, rather than the entity needing to have the *power* to cause them to occur. That is, it is sufficient for something good to be capable of happening from the economic resource, and for the entity to be able to obtain that good thing from its having happened, even though the entity cannot *make* that good thing happen. For example, a non-transferable two per cent interest in an exploratory oil well gives an entity a link to an economic resource (the interest in the exploratory oil well) that is capable of producing cash inflows. However, the entity does not have the power to cause the well to produce oil that can be sold to produce cash inflows; but if any oil is produced and sold, the entity will get those cash inflows.

72. We think, therefore, that it is sufficient that the entity can obtain the cash inflows (or reduced cash outflows) capable of being produced by the economic resource. Thus, the proposed working definition of an asset in paragraph 41 could be amended as follows:

> "An *asset* [of an entity] is a present economic resource~~, controlled by~~ from which the entity can obtain cash inflows (or reduce cash outflows) if any."

73. *Do you agree that having the power to cause cash inflows (or reduce cash outflows) from an economic resource* is a sufficient condition rather than a necessary condition in the context of an asset, and that the necessary condition is *that the entity can obtain cash inflows (or reduce cash outflows) from an economic resource?*

74. However, if we focus only on benefits flowing to the entity, we include situations in which the entity is just as capable of receiving benefits as any other entity. For example, an entity's use of a public good such as a public road or a bridge is capable of reducing cash outflows to the entity because, in the absence of the road or the bridge the entity might have to incur greater cash outflows to take an alternative route, or to build a road or bridge for itself. Thus, without further modification, the definition in paragraph 72, above, could result in public goods being assets of an entity.

75. We think that should not be the case. Accordingly, we need to specify that the entity's link to the asset must be one that is not available to all others. We tried to capture this notion in the proposed working definition of an asset by referring to "privileged access". However, that has not gained sufficient support. The notion that we wish to capture is that the entity can obtain cash inflows from the economic resource, but that others are, or can be, excluded from obtaining cash inflows from the economic resource. We think that we should capture this notion by referring to the exclusion of others from access to the economic resource and any cash inflows (or reduction in cash outflows) that it produces. Thus the definition would become:

> "An *asset* [of an entity] is a present economic resource from which the entity can obtain cash inflows (or reduced cash outflows), if any, to the exclusion of others."

76. We considered referring to cash inflows flowing *exclusively* to the entity. However, that can be read to imply that the benefits will flow *only* to the entity and would therefore not include

circumstances in which benefits might flow jointly to both the entity and another specified entity (or entities), but not to all entities. We think that is not the intent and, therefore, it is clearer to use the words *to the exclusion of others*.

77. Interestingly, the resultant working definition contains similarities to the UK Accounting Standards Board's explanation of what is necessary for an entity to have control of rights [or other access] to future economic benefits. The UK Statement of Principles explains that, "An entity will control the rights or other access if it has the ability both to obtain for itself any economic benefits that will arise and to prevent or limit access of others to those benefits." (paragraph 4.17).

78. *Do you think that we should improve the definition of an asset to replace the term* control*?*

79. *Do you think that we should use the definition in paragraph 75?*

An alternative

80. Having considered the analysis in this section of the paper, some might conclude that there was little wrong with the proposed working definition, other than the difficulty with its reference to *privileged* in the context of *access*. As an alternative to the definition in paragraph 75, we might modify the proposed working definition of an asset as follows:

> "An *asset* [of an entity] is a present economic resource to which the entity has a present right or other ~~privileged~~ access<u>, to the exclusion of others</u>."

81. *Do you think that we should use the definition in paragraph 80, rather than that in paragraph 75?*

Other Possible Amendments

82. We have considered two other alternative amendments to the definition of an asset. These comprise the following:

    a. Focus first on an entity's present rights, rather than on a present economic resource

b. Deal with the link between the entity and the economic resource as separate definition and recognition issues

Focus on an Entity's Rights Rather Than on a Present Economic Resource

83. Some think that we should focus first on an entity's present rights, rather than on a present economic resource. Thus, the definition of an asset might be:

> "An asset of an entity is its present right or other access, to the exclusion of others, to a present economic resource"

or:

> "An asset of an entity is its present right to cash inflows (or reduced cash outflows), if any, to the exclusion of others, from a present economic resource."

84. Like the proposed working definition, these alternatives avoid debates as to whether the asset is the right or the economic resource, since both a right and an economic resource are necessary. They also make it clear that not all rights result in assets—only those that are rights to economic resources, or rights to benefit from economic resources. The parallel structure of a *liability* definition would be, "A liability of an entity if its present obligation to a present economic burden."

85. We note that of all the definitions used by national standards setters only the UK focuses on the asset as being the *rights or other access*. All others focus on the asset as being the economic resource or economic benefits, rather than on the linkage of the entity to that resource. This is illustrated in the table in Appendix B. Thus, this approach would be unfamiliar (except in the UK).

86. Furthermore, we think that this alternative focuses on the wrong thing as being the asset. In the case of an example such as a lottery ticket, some think of these as not being assets because they think of the right to the future prize from the winning lottery ticket, rather than the right to the present promise from the lottery to allow the ticket-holder to participate in the drawing. That is, they focus on the right to the wrong economic resource. Similarly, it can lead some to think of a loan guarantee as not being an asset to its holder because the holder does not presently have the right to demand payment from the writer of the guarantee for a loan that has not gone into default.

87. Also, we note that in the proposed working definition of an asset, *right* (or other privileged access) replaces the word *control* in the existing definitions. We think that those who argue that the asset is the *right*, would not make the same argument that the asset is *control*.

88. The definitions above also require that *right* would need to be explained in amplifying text in the same manner as alternative 1 in paragraph 52, above, to explain that it includes more than just legal rights and might also include what we have described as *other privileged access*.

Separate Definition and Recognition Issues

89. Another approach would be to separate the question of whether there is an asset from the question of whose asset it is by treating the linkage of the entity to the economic resource as a recognition, rather than a definitional, question. That is, an asset would be defined as being *a present economic resource* and criterion for determining whose asset it is would be dealt with in recognition.

90. This might help to clarify that there are two separate questions to be asked:

    i. a definition question: Is there an economic resource?

    ii. a recognition question: Is it the entity's economic resource?

91. The advantage of this alternative is that it clearly separates the question of whether there is an asset from the question of whose asset it is. Thus, it makes clear that there are two separate questions to be answered (questions that many of those who focus on only the *right* as being the asset tend to collapse into a single question). It also defines an asset in a manner more similar to dictionary definitions, without dealing with the linkage to any particular entity.

92. A disadvantage of this alternative is that it would be unfamiliar. That is because both the existing IASB and FASB definitions of an asset, as well all other definitions we have consulted (see Appendix B) define assets as being those of the reporting entity, rather than in isolation from the entity. However, that might not be good reason in of itself not to pursue this alternative further. Some note that to define an asset in isolation would lead to an entity having to first identify all economic resources, and only later ask if they are *the entity's* economic resource and, therefore, should be recognised, rather than the entity focusing on

those economic resources to which it is linked. Furthermore, in some cases it might not be possible to determine whether something is an asset without knowing whose it is. For example, Unilever common shares are assets to investors in Unilever, but not to Unilever.

Summary Staff Recommendation

93. Compared to the present definitions, most of those consulted between December 2006 and March 2007 agreed that the proposed working definition of an asset includes improvements. However, it is evident that we have not sufficiently demonstrated the case for some of the improvements.

94. We continue to think that the changes to focus on economic resources rather than future economic benefits, to remove likelihood from the definition, and to focus on the present, rather than past transactions or other events, are changes worth pursuing. However, we think that we need to consider a different approach to the linkage between the economic resource and the entity—*rights or other privileged access* has clearly not received sufficient support.

95. We think that how far we go with changes to the existing definitions might depend on one's view of the objective of this phase of the Conceptual Framework project. Those who see the objective as primarily one of convergence might be more reluctant to introduce new terms in the definition and might be more comfortable continuing to refer to *control*, in spite of the difficulties with interpreting that term that we have highlighted earlier in this paper. Those who see the objective as to improve, as well as converge, might be more open to additional change.

96. We think that we should take the opportunity to improve as well as to converge the definitions of an asset. The project's objective certainly contemplates both convergence and improvement. However, we must also be realistic in assessing how far we can go—which is one of the reasons that we focussed the project on resolving cross-cutting issues. We think that most of the cross-cutting issues relating to the definition of an asset have now been resolved (with the exception of those that are linked with unit of account issues). Accordingly, we think that now is the time to decide how far we wish to go with the definition of an asset.

97. This paper sets out several alternative definitions of an asset as follows:

a. For those who seek primarily to converge:

> “An *asset* is a present economic resource controlled by the entity as a result of past [transactions or] events from which future economic benefits are expected to flow to the entity.” (see paragraph 22)

b. For those who would also like to improve the definition by removing the reference to likelihood:

> “An *asset* is a present economic resource controlled by the entity as a result of past [transactions or] events.” (see paragraph 32)

c. For those who would also like to improve the definition by removing reference to past [transactions or] events:

> “An *asset* is a present economic resource presently controlled by the entity” (see paragraph 41)

d. And, for those who would also like to improve the definition by dealing with issues associated with the meaning of control:

> “An *asset* [of an entity] is a present economic resource from which the entity can obtain cash inflows (or reduced cash outflows), if any, to the exclusion of others.” (see paragraph 75)

Or:

> “An *asset* [of an entity] is a present economic resource to which the entity has a present right or other access, to the exclusion of others.” (see paragraph 80)

The paper explores several other alternatives, none of which we recommend.

98. *We request that the Boards advise us which definition we should use as our working definition of an asset as we proceed with other aspects of Phase B of the Conceptual Framework project.*

APPENDIX A: PROPOSED WORKING DEFINITION OF AN ASSET

The following is the proposed working definition of an asset on which consultations took place in December 2006-March 2007.

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

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

b. An *economic resource* is something that has positive economic value. It is scarce and capable of being used to carry out economic activities such as production and exchange. It can contribute to producing cash inflows or reducing cash outflows, directly or indirectly, alone or together with other economic resources. Economic resources include non-conditional contractual promises that others make to the entity, such as promises to pay cash, deliver goods, or render services. Rendering services includes standing ready to perform or refraining from engaging in activities that the entity could otherwise undertake.

c. *A right or other privileged access* enables the entity to use the present economic resource directly or indirectly and precludes or limits its use by others. *Rights* are legally enforceable or enforceable by equivalent means (such as by a professional association). Other privileged access is not enforceable, but is otherwise protected by secrecy or other barriers to access.

Note that the definition focuses on the *capability* of producing cash inflows (or reducing cash outflows), rather than on the cash flows themselves that may result from that capability.

APPENDIX B: EXISTING DEFINITIONS OF AN ASSET

The following are definitions of an asset that we have consulted during the course of the project. The part of the definitions constituting the asset (as opposed to the link to the entity) is highlighted in bold in each case.

Definitions of an Asset	
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(a))
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[5]	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

5 *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. This definition is not repeated in the July 2007, final report. Rather, that report comments on the IASB/FASB working definition as follows, "… we believe that the definitions proposed by the staffs of the FASB and IASB for assets and liabilities, which are currently under consideration by the two boards, provide a sound starting point for addressing recognition." "We believe that as a practical matter, assets should be identifiable and separable, capable of being transferred to others. We do not believe that hard to identify, vaguely defined, or ambiguous items, such as goodwill, should be recognized in the balance sheet."

	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[6]	**An asset is a resource** that embodies economic benefits or services that the federal government can control. (paragraph 17)
GASB[7]	**Assets are resources** with present service capacity that the government presently controls.

6 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.*

7 Governmental Accounting Standards Board, June 2007, Concepts Statement No. 4, *Elements of Financial Statements.*