STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**		
Paper topic	**Asset definition: control**		
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OVERVIEW OF PAPER

1 This paper considers feedback on the definition of control suggested in the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*, and on the guidance accompanying that definition. The main recommendations are that:

(a) a requirement for control should remain in the definition of an asset;

(b) the *Conceptual Framework* should define control as 'the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it'; and

(c) supporting guidance should identify exposure to the significant risks and rewards of ownership as an indicator of control. However, the terminology should be consistent with that in IFRS 10. Instead of using the term 'risks and rewards of ownership', the *Conceptual Framework* should use wording that explains the meaning of that term, ie 'exposure, or rights, to variations in benefits'.

BACKGROUND

Preliminary views in Discussion Paper

2 Both the existing definition of an asset and the definition suggested in the Discussion Paper require the economic resource to be 'controlled by the entity'.

3 The existing *Conceptual Framework* does not define control. The Discussion Paper suggested adding the following definition:

> An entity controls an economic resource if it has the present ability to direct the use of the economic resource so as to obtain the economic benefits that flow from it.

4 This definition is based on the concepts that underlie the definitions of control in IFRS 10 *Consolidated Financial Statements* (in the context of control of an investee) and IFRS 15 *Revenue from Contracts with Customers* (in the context of derecognition of assets when control transfers to a customer). IFRS 15 states that:

> Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset'.[1]

5 Paragraphs 3.26-3.32 of the Discussion Paper suggested further guidance on control. The suggested guidance is reproduced in Appendix 1 to this paper, marked up to reflect the changes recommended by the staff.

Feedback

6 Most of the feedback received on the notion of 'control' was about the role of control in derecognition of assets. This feedback is discussed in Agenda Paper 10E *Conceptual Framework—Derecognition*.

[1] IFRS 15, paragraph 33.

7 Otherwise, there were no particular matters that generated widespread feedback and there were relatively few comments overall. The comments included:

(a) suggestions to replace or supplement the requirement for control with a requirement for exposure to the risks and rewards of ownership (paragraphs 8-13);

(b) suggestions to move the requirement for control from the asset definition to the asset recognition criteria (paragraphs 14-20);

(c) comments on the proposed definition of control (paragraphs 21-37); and

(d) comments on the supporting guidance (paragraphs 38-41).

ASSET DEFINITION—RISKS AND REWARDS OF OWNERSHIP

Feedback

8 Some respondents suggested that the definition of an asset should incorporate the notion of exposure to risks and rewards of ownership. Different respondents suggested different ways of incorporating the notion. Suggestions included:

(a) *replacing* the requirement for control in the asset definition with a requirement for the entity to have exposure to the risks and rewards of ownership;

(b) *adding* a requirement for the entity to have exposure to the risks and rewards of ownership;

(c) *equating* control with risks and rewards—stating that having control means having exposure to the risks and rewards of ownership; or

(d) identifying exposure to the risks and rewards of ownership as an *indicator* of control.

Staff analysis and recommendations

9 The staff do not recommend any of the first three of these suggestions:

(a) the question of whether assets should be defined by reference to control or exposure to risks and rewards of ownership was at the heart of many accounting debates in past years. Except in relation to derecognition of some assets, recent IFRSs now require only control.

(b) the IASB has concluded that entities will reach more consistent judgements about whether an item meets the definition of an asset if they make these judgements by reference to control, rather than exposure to the risks and reward of ownership.[2]

The staff do not think there are compelling arguments for reopening this debate.

10 The staff note that some recent Standards identify exposure to the significant risks and rewards of ownership (or, in other words, to variable returns) as an element or indicator of control:

(a) IFRS 10 states that 'an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee'[3]; and

(b) IFRS 15 has a list of indicators of the transfer of control of an asset to a customer. One of the indicators is that 'the customer has the significant risks and rewards of ownership of the asset'[4].

11 The Basis for Conclusions accompanying IFRS 15 explains that:

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2 See for example paragraph BC118(b) in the Basis for Conclusions accompanying IFRS 15.

3 IFRS 10, paragraph 6.

4 IFRS 15, paragraph 38(d).

> BC154 … The boards included the indicator 'the customer has the significant risks and rewards of ownership of the asset' because of comments from respondents who disagreed with the boards' initial proposal to eliminate considerations of the 'risks and rewards of ownership' from the recognition of revenue. Respondents observed that risks and rewards can be a helpful factor to consider when determining the transfer of control, as highlighted by the IASB in IFRS 10 *Consolidated Financial Statements*, and can often be a consequence of controlling an asset. The boards decided that adding risks and rewards as an indicator provides additional guidance, but does not change the principle of determining the transfer of goods or services on the basis of transfer of control.

12 The staff think that:

(a) it would be helpful if the *Conceptual Framework* explains in general terms the relationship between control and exposure to risks and rewards of ownership;

(b) the explanation should be consistent with the IASB's decisions in IFRS 15—exposure to the significant risks and rewards of ownership may indicate control; and

(c) the terminology should be consistent with that in IFRS 10. Instead of using the term 'risks and rewards of ownership', the *Conceptual Framework* should use wording that explains the meaning of that term, ie 'exposure, or rights, to variations in benefits'.

13 Accordingly, the staff suggest the following supporting guidance:

> The ability to direct the use of an economic resource can often give an entity exposure, or rights, to variations in the amount of economic benefits generated by that resource. Having exposure, or rights, to the significant variations may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of control.

Question for the IASB

Question 1: Control or risks and rewards of ownership
The staff recommend that: (a) the definition of an asset should continue to require an economic resource to be 'controlled' by the entity. The definition should not be changed so it instead (or in addition requires the entity to have exposure, or rights, to the significant risks and rewards of ownership of the resource. (b) supporting guidance should identify exposure to the significant risks and rewards of ownership as an indicator of control (but only one factor to consider in the overall assessment). (c) the terminology should be consistent with that in IFRS 10. Instead of using the term 'risks and rewards of ownership', the *Conceptual Framework* should use wording that explains the meaning of that term, ie 'exposure, or rights, to variations in benefits'. Do you agree?

CONTROL—ASSET DEFINITION or RECOGNITION CRITERION

Background

14 At present the requirement for control is in the asset definition. In other words, the *Conceptual Framework* defines ‘an asset of the entity’ rather than ‘an asset’. During the development of the Discussion Paper, the IASB considered moving the requirement for control from the definition of an asset to the asset recognition criteria. The effect would have been that the definition of ‘an asset’ would not have referred to control, and an entity would recognise the assets it controls.

15 However, the IASB decided not to proceed with this suggestion because it did not identify any significant practical problems that the change would address.

Feedback

16 Most respondents did not comment on whether the requirement for control should be in the definition of an asset or in the recognition criteria. A few respondents suggested explicitly that it should remain in the definition of an asset, because:

(a) control appropriately links an asset to the reporting entity, which is consistent with the ‘entity perspective’.

(b) it would not be efficient first to define assets and liabilities without a link to the entity and then establish the link in the recognition criteria. Hence, fish in the open sea should not meet the definition of an asset. They become assets of a particular entity only when they are caught. Thus, the reporting entity need not identify all possible assets before then using the recognition criteria to eliminate those assets that are not assets of the reporting entity.

17 Others believe that the requirement for control should be a recognition criterion, rather than part of the definition of an asset. They argued that:

(a) this approach would separate two questions that are independent of each other:

i) does an asset exist?

ii) who does the asset belong to? (who should account for it?)

(b) defining who must account for a resource should be the subject of particular Standards. This question is too specific to tackle by a definition in the *Conceptual Framework*.

Staff analysis and recommendation

18 The staff note that moving the requirement for control from the asset definition to the asset recognition criteria is unlikely to change the population of recognised assets—there are no problems in practice that the IASB would be seeking to address if it made this change.

19 Further, moving the requirement for control would add some complexity to the recognition criteria. The IASB has tentatively decided that the *Conceptual Framework* should not establish any other criteria that would govern the recognition assets or liabilities in all circumstances: it should instead describe factors to consider in deciding whether to recognise an asset or a liability. The requirement for control would have to be added as the sole recognition criterion for assets, and the IASB would need to consider specifying an equivalent recognition criterion for liabilities (such as the entity being bound by the obligation).

20 For these reasons, and for the reasons given by respondents in paragraph 16, the staff recommend that the requirement for control should not be moved from the asset definition to the asset recognition criteria.

Question for the IASB

Question 2: Control—asset definition or recognition criterion
The staff recommend that the requirement for control should not be moved from the asset definition to the asset recognition criteria? Do you agree?

DEFINITION OF CONTROL

21 The Discussion Paper suggested the following definition of control:

> An entity controls an economic resource if it has the present ability to direct the use of the economic resource so as to obtain the economic benefits that flow from it.

Feedback

22 There were relatively few comments on this definition. Some respondents explicitly welcomed a concept that could be applied (and if necessary fine-tuned) in individual standards. A few respondents explicitly supported the emphasis on the ability of the entity to obtain the economic benefits.

23 A few respondents noted that the definitions of control in current and proposed standards on revenue recognition, consolidation and leases are not the same. Some suggested that the IASB should clarify which control model it is using in the *Conceptual Framework* and explain how that model applies to different transactions and items. Some suggested that the same definition should be used in the *Conceptual Framework* and in individual IFRSs.

24 A few respondents suggested specific changes, most of which would align the *Conceptual Framework* definition more closely with the definitions in one or more Standards. Specifically, they suggested:

(a) omitting the definition on the grounds that it is redundant (see paragraphs 25-26);

(b) adding the modifier 'substantially all' to the reference to economic benefits (see paragraphs 27-32); or

(c) more clearly identifying two separate criteria: the ability to direct the use of the economic resource <u>and</u> the ability to obtain the economic benefits that flow from it (paragraphs 33-37).

Is the definition of control redundant?

25 A few respondents questioned the need for a definition of control. They argued that it is implicit in the definition of a resource as a 'right' that the entity controls the resource.

> The definitions of economic resource and control are in a way circular. An economic resource is by definition something that is scarce, and using it will generate economic benefits in future. Scarcity in itself implies control, so does control really need to be defined separately? Further, the focus on rights rather than physical resources also implies the existence of control.
>
> *University of Gothenburg School of Business, Economics and Law*

26 The staff agree that it may be implicit in the definition of an economic resource that the party that controls that resource has the ability to use the right and obtain the benefits that the right produces. However, we think that stating this link in a single-sentence description of control is a useful way of introducing the rest of the supporting guidance on control. Consequently, we recommend starting that guidance with the definition.

Add 'substantially all' to the reference to economic benefits

27 The IFRS 15 definition of control refers to a customer's ability to obtain 'substantially all' the benefits from the asset.

28 The Discussion Paper explained the reason for not including 'substantially all' in the definition suggested for the *Conceptual Framework*:

(a) a threshold such as 'substantially all' need be considered only for Standards, such as IFRS 15, that treat assets that might comprise bundles of rights as a single unit of account, and require the entity to derecognise the entire unit of account on transfer of a sufficient proportion of the rights.

(b) for any other situations, the inclusion of 'substantially all' is redundant, and potentially confusing, if an entity recognises only the rights it controls.

29 A few respondents suggested adding ‘substantially all’ to the definition proposed for the *Conceptual Framework*. They argued that:

(a) the question of whether an entity has substantially all, or all, of the benefits is separate from whether those benefits relate to all or a proportion of the asset.

(b) including ‘substantially all’ may assist the IASB when it considers whether an asset should be derecognised, and avoid marginal changes resulting in derecognition.

(c) the IASB should not delete ‘substantially all’ until it has completed its discussions on the notion of portions of assets.

30 The staff do not agree that the question of whether an entity has substantially all, or all, of the benefits is separate from the question of whether those benefits relate to all, or a proportion of the asset. The Discussion Paper suggested that an entity’s asset should be defined by the rights it controls and the benefits that can be obtained from these rights. If an entity does not have a right to obtain some minor benefits, the right to those benefits is not the entity’s asset—it is another party’s asset. That right should not be included within the bundle of rights that are accounted for together as a single asset (unit of account).

31 Some additional factors arise for accounting decisions about derecognition because of the need to consider the nature of the information that results from derecognition. In Agenda Paper 10E *Conceptual Framework—Derecognition*, the staff recommend that, if an entity retains a component of an asset (ie transfers some but not all of the rights within a unit of account), the IASB should determine when developing or revising particular Standards how the entity would best portray the changes that resulted from the transaction. In some cases, the IASB might specify that the entity continues to recognise the asset until it has transferred the rights to substantially all the benefits. However, it might decide to apply a different threshold, or take a completely different approach.

32 Consequently, the staff recommend that the ‘substantially all’ threshold should not be part of the general definition of control in the *Conceptual Framework*.

Clarify whether the ability to direct is a criterion separate from the ability to obtain benefits

Background

33 There is another difference between the definition of control in IFRS 15 (and proposed in the Exposure Draft *Leases*) and the definition suggested in the *Conceptual Framework* Discussion Paper. Whereas the definition in IFRS 15 (and proposed in the Exposure Draft *Leases)* requires the entity to have the ability to direct the use of the asset and obtain the benefits from it, the definition suggested for the *Conceptual Framework* requires the entity to have the ability to direct the use of the economic resource so as to obtain the economic benefits that flow from it.

34 The wording suggested in the Discussion Paper reflects a notion in IFRS 10. Like IFRS 15, IFRS 10 defines control to include both an ability to direct (power) and an ability to obtain benefits (exposure or rights to variable returns). However, IFRS 10 goes on to specify that the entity has control only if it has the ability to use its power to affect the amount of the returns. The definition of control suggested in the Discussion Paper picked up this notion by stating that, to control an economic resource, an entity must have the ability to direct the use of the economic resource *so as* to obtain the benefits that flow from it.

Feedback

35 A few respondents suggested that the *Conceptual Framework* should be clearer as to whether there are two separate criteria that need to be satisfied to meet the definition of control. One respondent stated that some readers of the Discussion Paper had interpreted the suggested definition to mean that the ability to obtain the benefits of an economic resource is sufficient for the entity to control the resource (the ability to direct the use of the resource is no more than the means by which entity obtains the benefits). However, that respondent thought that such an interpretation of ‘ability to direct’ was more passive than the generally accepted meaning.

36 This feedback suggests that:

(a) it is not clear from the suggested definition that there are two criteria in the definition of control; and

(b) the difference between the suggested definition for the *Conceptual Framework* and the definition in IFRS 15 (and suggested in the Exposure Draft *Leases*) may imply a difference of substance and raise questions about the practical implications of the difference. We did not intend there to be a difference of substance on this matter.

37 Accordingly, the staff recommend refining the definition for the *Conceptual Framework*:

> An entity controls an economic resource if it has the present ability to direct the use of the economic resource ~~so as to~~ and obtain the economic benefits that flow from it.

Question for the IASB

Question 3: Definition of control

The staff recommend that the *Conceptual Framework* should state that:

An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that flow from it.

Do you agree?

GUIDANCE TO SUPPORT THE DEFINITION OF CONTROL

38 Paragraphs 3.26-3.32 of the Discussion Paper suggested further guidance to support the definition of control.

Suggestions for which the staff recommend changes to the suggested guidance

39 The staff recommend two changes to this guidance:

(a) to add, at the suggestion of some respondents, clarification that control includes the ability to prevent other parties from directing the use of, and obtaining the benefits from, the economic resource. This statement is in IFRS 15[5], and it is a general concept that clarifies that an entity does not control rights that are freely available.

(b) to delete the examples of situations in which an entity does not control an economic resource because the resource is freely available to any other parties. We suggest that, whilst these examples were useful for the Discussion Paper, only the concepts themselves should be in the *Conceptual Framework*.

40 These recommended changes are marked in Appendix 1.

Suggestions for which the staff recommend no changes to the suggested guidance

41 Respondents asked for more guidance on several matters relating to control. The staff do not recommend adding more guidance on these matters, in most cases because we think that they concern specific transactions, and not general concepts. They are listed in Appendix 2, along with the staff's reasons for recommending no changes.

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5 IFRS 15, paragraph 33.

Question for the IASB

Question 4: Supporting guidance on control
The staff recommend that the *Conceptual Framework* should include supporting guidance on the meaning of control, based on the guidance suggested in paragraphs 3.26-3.32 of the Discussion Paper but: (a) adding clarification that a component of control is the ability to prevent other parties from directing the use of, and obtaining the benefits from, the economic resource; and (b) deleting some of the examples that were included in the Discussion Paper to illustrate the concepts. Do you agree?

Appendix 1—draft text for the Exposure Draft

The text below is a sketch of the concepts that could be included in the Exposure Draft.

The unmarked text is that suggested in paragraphs 3.23 and 3.26-3.32 of the Discussion Paper. The marked changes are to implement the staff recommendations in this paper.

The draft text is sketched here only to give IASB members an idea of the broad content and level of detail envisaged by the staff—we are not asking the IASB to approve the draft text at this meeting. With more time, we can improve the drafting and consider other factors, such as the extent to which we should weave the new concepts into the existing *Conceptual Framework* text (rather than draft it from scratch).

Assets

…

Control

X.01 An entity controls an economic resource if it has the present ability to direct the use of the economic resource ~~so as to~~ and obtain the economic benefits that flow from it. A component of control is the ability to prevent other parties from directing the use of, and obtaining the benefits from, the economic resource.

X.02 An entity has the ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities or to allow another party to deploy the economic resource in that other party's activities.

X.03 The ability to direct the use of an economic resource can often give an entity exposure, or rights, to variations in the amount of the economic benefits generated by that resource. Having exposure, or rights, to the significant variations may indicate that the entity controls the resource. However, it is only one factor to consider in the overall assessment of control.

X.04 Many economic resources are legally enforceable rights that establish the entity's ability to direct the use of the economic resource. However, sometimes an entity establishes its ability to direct the use of an economic resource by having access that is not available to others. This can be particularly relevant for assets such as know-how and customer lists.[6]

~~X.05 An entity does not control an economic resource if it does not have the present ability to direct the use of the economic resource. Consequently the following are not assets of an entity:~~

~~(a) rights of access to public goods, such as open roads, if similar rights are available to any party at no cost;~~

~~(b) fish in water to which access is not restricted. Although a potential source of economic benefits, this is not an economic resource of any one entity because those benefits are available to any party. (An exclusive right to catch fish would be an asset of an entity that has that right. Similarly, if fishing quotas are introduced, the quota of each party would become an asset of that party, though the rights associated with possession of the fish would still not become an economic resource until the fish are caught.)~~

~~(c) knowledge that is in the public domain and freely available to anyone without significant effort or cost. No party controls such knowledge.~~

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6 In May 2014, the IASB tentatively decided that:

(a) the definition of an economic resource should not include the notion of 'other source of value' that was suggested in the Discussion Paper;

(b) the guidance supporting the definition of an economic resource should confirm that the notion of a 'right' is broad enough to capture any know-how that is controlled by keeping it a secret'.

This guidance supporting the definition of an economic resource could replace or amend the guidance suggested in paragraph X.04 above. The staff will address the interaction in drafting.

X.05 The economic benefits must flow to the entity (either directly or indirectly) rather than to another party. This requirement does not imply that the entity can ensure that the resource will generate economic benefits in all circumstances. Instead it means that, if the resource generates economic benefits, the entity is the party that will receive them.

X.06 If an entity holds a resource as agent, rather than as principal, the economic benefits arising from the resource flow to the principal rather than to the agent. Consequently, the agent does not control the resource and does not have an asset. (Accordingly, the agent also has no obligation to transfer the economic benefits derived from the asset.)

X.07 If an entity holds a resource, and is bound by a separate requirement, such as a contractual requirement or legislation, to pass through to another party all the economic benefits flowing from the resource, the entity holds that resource as agent for the other party. Thus the entity has no asset or liability.

X.08 When determining whether an entity controls an economic resource, it is important to identify the economic resource correctly. For example, entities A, B and C may jointly own real estate on terms that provide them with 25 per cent, 40 per cent and 35 per cent of the economic benefits flowing from that real estate. In the absence of any other agreements that modify control, each party controls its proportionate interest in the underlying economic resource (in this example, the real estate). No single party controls the underlying real estate in its entirety.

Appendix 2—suggestions for which staff recommend no changes to the guidance

Respondent suggestion	Staff reasons for recommending no changes
Clarify that prudence should play a role. If it is not clear that an entity has control, the presumption should generally be that it does not.	The IASB has tentatively decided to reintroduce a general reference to prudence in the *Conceptual Framework*. This reference can be applied to all situations in which entities are required to make judgments under conditions of uncertainty, and would be considered when developing or amending individual Standards.
Clarify whether, and if so when, an entity controls know-how, customer relationships and existing work force. These have been the difficult cases in the past. Similarly, can an entity control pension fund assets and pension fund surpluses?	These are specific application questions that could be addressed in the context of specific transactions when the IASB is developing or amending the applicable Standard.
Add concepts to address situations in which an entity has the ability to direct 100% of the activities of an economic resource but obtains less than 100% of the economic benefits.	"
Clarify whether, for operations that are jointly controlled, an entity controls a proportion of the assets used in the operations, or the right to cash flows from that asset. The characterisation of the entity's asset could affect how it evaluated for control purposes.	"
Add more guidance to address principal-agent situations. The Discussion Paper states that an agent should not recognise assets held on behalf of a principal. It does not adequately address assets—such as goods and services taxes collected on behalf of the government—that the agent may need to recognise. It does not explain whether the principal does have control.	The *Conceptual Framework* is aiming to state only the general concept that an agent does not control the economic resource that it holds on behalf of a principal. Any consideration of whether an entity is acting as an agent in a particular transaction should be addressed in the applicable Standard. There is, for example, application guidance in IFRS 15.[7]

[7] IFRS 15, Appendix B Application Guidance, Principal versus agent considerations, paragraphs B34-B38.

Respondent suggestion	Staff reasons for recommending no changes
The guidance suggests that information is not controlled by an entity if it is freely available. The point is not whether it is freely available (which patented information might be) but whether it can be freely used.	We agree with this point, but have recommended deleting the paragraph of guidance to which it refers (paragraph X.05 in Appendix 1).
The guidance suggests that a degree of exclusivity is required. However, lack of exclusivity does not prevent a right from being an asset—it affects the measurement of the right.	We have recommended deleting the paragraph of guidance to which this comment refers (paragraph X.05in Appendix 1). We think that the general concept added to paragraph X.01 (the concept that control includes the ability to prevent access to other parties) is widely accepted.