Conceptual Framework

Elements 1: Asset Definition

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Introduction

1. This paper is for the first discussion of the "elements" phase of the joint IASB/FASB conceptual framework project. It focuses on the definition of an asset.

2. This paper first identifies similarities and differences between the definitions that are presently contained in the IASB *Framework for the Preparation and Presentation of Financial Statements* (IASB *Framework*) and the FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6), as well as differing aspects of definitions of an asset in conceptual frameworks of other standard setters. The paper then considers whether the definition of an asset for accounting purposes should differ from the general usage of the term and whether a distinction should be made between assets that are recognized and assets that are not recognized. Finally, the paper considers the essential characteristics of an asset and develops a proposed working definition.

3. The paper attempts to reason from first principles.[1] It also attempts not to "peek ahead"[2] and, therefore, does not consider the consequences of the definition for particular conclusions reached in accounting standards today. The consequences for certain situations identified in cross-cutting issues will be considered in a separate paper, expected to be developed for discussion in February 2006. This paper does not consider options over assets or the effects of uncertainty, each of which are scheduled for discussion later in 2006.

[1] Precept No. 2.
[2] Precept No. 8.

4. This paper discusses the cross-cutting issues as they arise, rather than in numerical order. Cross-cutting issues addressed in this paper are as follows:

EL1: Should assets be defined in terms of rights or resources? E.g., securitisation—selling rights to future revenues, but those rights are not recognised. (see paragraph 39)

EL3: What is controlled—the resource/right that gives rise to future economic benefits or the future economic benefits themselves? (see paragraph 36)

EL6: (a) Does control belong in the asset definition or should it be part of the recognition criteria? (see paragraph 53) (b) Is it preferable to have a broad set of assets at the elements level that is refined at the recognition level? (see paragraph 18)

EL7: What is the event that results in an asset being "obtained or controlled" by an entity? (see paragraph 59)

EL8: Are accounting assets different from economic assets? If so, why? (see paragraph 11)

5. A summary of the issues and staff recommendations is at the end of the paper, together with an appendix summarizing cross-cutting issues remaining to be considered, relating to the definition of an asset (Appendix A). For convenience, the proposed working definition of an asset also is set out here:

An asset of an entity is a present right, or other access, to an existing economic resource with the ability to generate economic benefits to the entity.

Existing Definitions of an Asset

IASB and FASB Definitions

6. The IASB *Framework* defines an asset in the following manner:

> An asset is a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.[3]

CON 6 defines assets as follows:

> Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.[4]

[3] IASB *Framework*, paragraph 49.
[4] CON 6, paragraph 25, footnote reference omitted.

Similarities

7. The two definitions contain a number of common characteristics:

   (a) Each definition makes reference to “future economic benefits.”

   (b) Each definition considers that an asset is something that is “controlled” by the entity.

   (c) Each definition requires that the asset result from “past (transactions or) events.”

   (d) Each definition includes a degree of likelihood (IASB—“expected,” FASB—“probable”).

Differences

8. However, there also are a number of differences between the two definitions, including the following:

   (a) The IASB *Framework* focuses on “resources” controlled by the enterprise, whereas the FASB definition focuses on “future economic benefits” controlled by the enterprise. Said another way, the IASB *Framework* requires that “resources” be controlled, whereas the FASB definition requires that “future economic benefits” be controlled. (see paragraph 36 et seq.)

   (b) The FASB definition requires that future economic benefits be “obtained or controlled. The IASB *Framework* requires “control,” only. (see paragraph 54)

   (c) The IASB *Framework* focuses on past events. The FASB definition focuses on “past <u>transactions or</u> events.” (see paragraph 58)

   (d) The IASB *Framework* focuses on “expected”. The FASB definition focuses on “probable”. (see paragraph 64 et seq.)

Other Standard Setters

9. Some national standard setters have developed definitions of assets more recently than either the IASB or FASB. These definitions are included in Appendix B to this paper. Key aspects of those definitions considered in this paper include the following:

(a) The UK *Statement of Principles for Financial Reporting* (UK SOP)[5] introduces the idea that assets are "rights or other access" to future economic benefits.

(b) The New Zealand definition refers not only to future economic benefits, but also to "service potential."[6]

Economic assets, Accounting Assets, and Recognition Criteria

Assets in General Usage

10. The *Shorter Oxford English Dictionary*[7] defines an asset, figuratively, as, "A thing or person of use or value."

Thus, in a non-accounting sense, if one were to start to list "assets," one might, intuitively, list items such as land, buildings, plants and machinery, amounts receivable, contracts including financial instruments, workforce, confirmed future orders for products, goodwill, brands, market share, reputation, proprietary information, roads, parks, and mineral resources.[8] All of these would seem to be things (or persons) of use or value and thus are candidates for a general definition of an asset.

Are Accounting Assets Different from Economic Assets?

11. From general usage, one might identify a large number of things that might be considered assets. The question then becomes whether all of these things are the types of things that one would want to provide information about in financial reports. This is the essence of cross-cutting issue EL8: *"Are accounting assets different from economic assets? If so, why?"* We[9] might rephrase this issue as: "Are what we call assets for accounting purposes, different from economic resources?"

12. First, we might ask what an "economic resource" is. CON 6 states that, "The kinds of items that qualify as assets under the definition [of an asset]…are also commonly called

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5 Accounting Standards Board, *Statement of Principles for Financial Reporting*, October 1999.

6 Other conceptual frameworks, including those of the FASB and Australia, also discuss the role of "service potential".

7 Oxford University Press, Fifth Edition (2002).

8 Other examples are included in Appendix C to this paper.

9 "We" is used in this paper to refer to the staff.

economic resources. They are the scarce means that are useful for carrying out economic activities, such as consumption, production, and exchange."[10] A 1976 FASB Discussion Memorandum[11] notes that:

> "Economic resources" is defined in various ways in the economics literature, but the term commonly comprises the natural resources (land, minerals, timber, etc.) and man-made resources (capital goods) to which labor is applied to produce consumer goods or additional capital goods. Labor is sometimes called an economic resource, and time often is. Product (output) is often described separately unless it becomes capital goods of another producer. Other factors—such as monopoly rights or monopoly power and entrepreneurship— that help produce value are also usually identified separately. The term "economic resource" is commonly used with a broad meaning in accounting literature, often encompassing all of the kinds of terms just described….

This suggests that accounting assets are very similar to economic resources. Indeed, it seems likely that all accounting assets are economic resources.[12] However, are all economic resources accounting assets?

13. The answer depends on how one defines economic resources. The 1976 FASB Discussion Memorandum takes a very broad view of economic resources. However, CON 6 introduces some critical criteria—that the resources are scarce and that they are useful for carrying out economic activities such as consumption, production, and exchange. This excludes resources that are not scarce, such as air or water,[13] as well as resources that are not useful to an entity's activities, such as a child's drawing or a memento or keepsake of purely sentimental value.

14. In conclusion, we think that accounting assets do include all economic resources, but only if economic resources are defined in a manner to restrict them to those that are scarce and useful for carrying out economic activities, such as consumption, production, and exchange.

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[10] CON 6, paragraph 27.

[11] FASB Discussion Memorandum, December 2, 1976, "Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement," pages 59–60.

[12] Proponents of a revenue and expense view of financial reporting are less concerned with whether assets represent economic resources and would include, also, as assets "deferred charges" that are necessary to achieve matching of costs and revenues. However, those proponents usually fail to establish a robust view of what constitutes revenue and expense without referring to assets. Hence, we take the view that we should start with a robust definition of an asset.

[13] We acknowledge that in some circumstances air or water might be scarce, in which case it might qualify as an asset–such as water in a storage tank in a desert, or highly filtered air in a laboratory.

15. We note that, if we do not take this view, we are at risk that economic resources might be considered assets depending on the manner in which they are acquired. For example, in present accounting for a purchase business combination an entity might pay an amount that represents not only the value of accounting assets, but also other economic resources. These are recognized in a business combination, but not in other circumstances.[14]

16. Furthermore, we think that we should refer to an "existing economic resource," to preclude the possibility that an asset might include future economic resources, including those that might arise from future transactions (such as cash from future sales).

17. Since all accounting assets are economic resources, we can start to build a proposed working definition of an asset for accounting purposes by replacing "a thing or person" with "an existing economic resource". Hence we get:

    An asset is an existing economic resource of use or value.

The Role of Recognition

18. Cross-cutting issue EL6(b) asks: *"Is it preferable to have a broad set of assets at the elements level that is refined at the recognition level?"*

19. Recognition is described in the IASB *Framework* as the process of putting something on the balance sheet (or income statement). The FASB Concepts Statements also state that, "Recognition is the process of formally recording or incorporating an item in the financial statements of an entity as an asset, liability, revenue, expense, or the like."[15] Both the IASB *Framework* and FASB Concepts Statements continue to note that recognition includes depiction of an item in both words and numbers, with the amount included in the totals of the financial statements. Assets are candidates for being recognised in financial statements or disclosed in notes to the financial statements or elsewhere in financial reports. Therefore, we do not want to use recognition criteria as a back-door means of

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[14] The reason that we are prepared to recognize some things in a purchase business combination, but not in some other circumstances, might have more to do with the fact that we have more reliable measurement—we have a purchase price—and hence are more comfortable about recognition, rather than having any fundamentally different view as to what constitutes an asset.

[15] FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 6.

restricting what is an asset. Using recognition criteria in this manner would only deal with those assets recognized in financial statements.

20. It is not the purpose of this paper to deal with recognition.[16] However, it is worth noting that typical reasons for not recognizing include inability to reliably measure and lack of probability that any future economic benefit will flow to the entity. The first of these is a practical accommodation. The second will be considered later in this phase of the conceptual framework project when we consider the role of uncertainty in recognition.

21. At this stage, we think it preferable to reserve the right to conclude that certain things that meet the definition of an asset for accounting purposes might, nonetheless, not be recognized for practical reasons.[17] Thus, we might conclude that certain assets should be recognized and other assets should not be recognized. This allows the standard setter some control over what assets are suitable for recognition. However, once we come to consider recognition, we should resist the temptation to "refine" the definition of an asset through the recognition criteria (effectively amending or revising the asset definition). If we conclude that certain things that meet the definition of an asset should not be recognized for other than specified practical reasons (such as the inability to measure), we may need to revisit the definition of an asset at that time.

22. In summary, we have concluded, to this point, that certain things may not qualify as "economic resources," and hence not be assets for accounting purposes. However, for there to be an asset for accounting purposes, there must be an economic resource (as defined in paragraph 14). Even once we have ascertained what constitutes an asset, some of these things may not be suitable for recognition.

Essential Characteristics of Assets

23. Most of the remainder of this paper considers the three essential characteristics of assets, as included in current definitions:

    (a) Future economic benefits

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[16] Recognition will be considered later in this phase of the conceptual framework project.
[17] Nonetheless, information about them may still be included in notes or elsewhere in financial reports.

(b) Control

(c) Past events.

At the end of the paper we briefly comment on the role of probability or expectations (likelihood).

Essential Characteristics of Assets: Future Economic Benefits

24. Future economic benefits are featured in both the IASB and FASB definitions of an asset.[18] The IASB *Framework* explains that, "The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity."[19] Similarly, CON 6 states that one of the three essential characteristics of an asset is that "…it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows…"[20]

25. We have concluded in Phase A of the conceptual framework project that, "Financial reporting should provide information to help present and potential investors and creditors and other users assess the amounts, timing, and uncertainty of prospective net cash inflows to the entity."[21] Furthermore, we have concluded that, "…financial reporting should provide information about the economic resources of the entity (its assets) …"[22] and that, "Information about a business entity's economic resources … can tell a user of its financial reports much about the entity's ability to generate favorable cash flows."[23] Thus, the reason that we provide information about economic resources is to provide financial statement users with information about an entity's ability to generate favourable cash flows.

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

[19] IASB *Framework*, paragraph 53.

[20] CON 6, paragraph 26.

[21] See draft Chapter of Objectives of Financial Reporting, IASB/FASB Agenda Paper 8B, October 2005, paragraph OB17.

[22] Ibid, paragraph OB20.

[23] Ibid, paragraph OB21.

26. It follows, from the objectives of financial reporting, that the kinds of things that should be reported in the financial statements would be those things that are capable of generating favourable cash flows. References to future economic benefits in the definition of an asset are an indirect way of linking to this objective. Indeed, the manner in which future economic benefits is explained by the IASB and FASB, as quoted in the previous paragraph, comes much closer to the objective.

27. We considered whether it might be an improvement to directly link to this objective by referring to "the ability, singly or in combination with other assets,[24] to generate favourable cash flows," rather than referring to "future economic benefits." While we think that this would be an improvement for business entities, this might be less suitable for not-for-profit organizations.[25] CON 6[26] explains that both "service potential" and "future economic benefits" eventually result in future cash flows. However, it goes on to note that not-for-profit organizations are different, in that the provision of services by not-for-profit organizations may not result in future cash flows. This might be why the New Zealand conceptual framework explicitly includes "service potential" as well as "future economic benefits" in the definition of an asset, as it is concerned with sector neutral standards. The *Australian Statements of Accounting Concepts*, which also reflect similar sector neutral objectives, do not include "service potential" in their definition of an asset, but do state that service potential is synonymous with future economic benefits. This seems to be an extension of the concern, raised at the joint IASB/FASB meeting in October 2005, that focussing the objective of financial reporting on future cash flows does not work as well for not-for-profit organizations and public sector entities. Neither of these types of entity are presently within our scope.

28. On balance, we think that we should use the term *economic benefits* rather than *favourable cash flows* in the definition of an asset.[27] Although we think that material supporting the

[24] In order that the definition does not become too lengthy, it might be preferable to deal with the phrase "singly or in combination with other assets" in supporting material, rather than in the definition itself. We discuss the need for this phrase in paragraph 31.

[25] The same might be said for public-sector entities, which also are not within our scope at the moment.

[26] CON 6, paragraph 28.

[27] One might also take the view that replacing economic benefits with favourable cash flows breaches precept 1, in that nothing is broken with the term *economic benefits*. However, some, at least, find the term unclear. For example, Davies & Davies in their article "What is an Asset", Part II, *Certified Accountant*, August 1996, state

definition of an asset should explain that, for business enterprises, economic benefits are equivalent to favourable[28] cash flows.

29. Taking our proposed working definition of an asset in paragraph 17, we might replace "of use or value" with "the ability to generate economic benefits". Thus, we get:

An asset is an economic resource <u>with the ability to generate economic benefits</u>.

30. Two particular aspects of this working definition might be noted. First, that it refers to "the ability" to generate economic benefits. Thus there is no need to demonstrate that economic benefits will occur; merely to establish that there is a capability of that being the case. Secondly, the definition does not refer to "future" or "prospective" economic benefits. This seems redundant as long as the economic resource has the ability presently[29] to generate economic benefits. These economic benefits could hardly be in the past.

31. We set aside, for a moment, above, the phrase "singly or in combination with other assets." The draft Chapter of the Converged Framework on Objectives of Financial Reporting explains the need for this as follows:

> …some of an entity's resources, such as accounts or notes receivable, are direct sources of future cash receipts, and many obligations, such as accounts or notes payable, are direct causes of future cash payments. However, many of the cash flows generated by a business entity's operations are the joint result of combining several of its resources to produce or provide and market goods or services. Although those cash flows cannot be identified with individual resources …, investors, creditors and others need to know the nature and quantity of the resources available for use in a business entity's operations ….[30]

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that they believe the meaning of the term to be "anything but obvious," and equate it to "having a future monetary value" — which is not dissimilar from having the capacity to generate favourable cash flows. Samuelson, R.A., in "The Concept of Assets in Accounting Theory," *Accounting Horizons*, Vol. 10 No. 3 September 1996, argues that the term "economic benefits" should be avoided because it connotes financial benefits and leads to confusion of definition with measurement. Favourable cash flows hardly helps in this regard. He suggests focusing on rights to uses of wealth. However, this seems no clearer. If we decided to revert to "economic benefits," rather than "favourable cash flows" it would not upset the remainder of the analysis in this paper.

28 In reviewing the draft chapter of the converged framework on Objectives of Financial Reporting, some Board members have questioned what is meant by "favourable cash flows" and suggested that we should be more specific as to whether we mean "cash inflows" or "net cash inflows". We have not yet resolved what to do with that suggestion. The same point would apply here.

29 We will return to the requirement for a "present" capability later, when we discuss rights or other access.

30 Draft Chapter of Objectives of Financial Reporting, IASB/FASB Agenda Paper 8B, October 2005, paragraph OB21.

We think that this should be explained in supporting guidance, rather than being included directly in the definition of an asset.

32. A further issue needs to be considered regarding economic benefits. That is identified in cross-cutting issue EL5:"*Which future economic benefits are included—where does the asset end?*" We intend to consider this issue in February 2006.

Essential Characteristics of Assets: Control[31]

Associating Assets with a Particular Entity

33. So far, we have considered what an asset is, only in the abstract. We have not related it to a particular entity. Ideally, an asset should appear in only one entity's financial reporting[32] and an entity should not include another entity's assets in its financial report.[33] If we are to determine what assets a particular entity must include in its financial reporting, we must consider what an asset of an entity is.

34. Traditionally, an asset is associated with an entity by the inclusion of "control" in the definition of an asset. The IASB *Framework* definition of an asset states that "…an asset is a resource controlled by the entity …"[34] (emphasis added). Similarly, the FASB definition states that "…assets are probable future economic benefits obtained or controlled by a particular entity …"[35] (emphasis added, footnote reference omitted). Setting aside, for the moment, the question of whether it is the resource or the economic benefits that is being controlled (see cross-cutting issue EL3, in paragraphs 36-38, below), both definitions require that the entity have control.[36] One might ask, however, what control means, what it is that the entity controls, and whether control is needed?

31 Issues relating to options over assets will be dealt with at a future meeting.
32 Although the same asset might appear in individual financial statements of a reporting and consolidated financial statements of a larger reporting entity containing those of the individual reporting entity.
33 A particular thing might provide separate benefits to two or more entities at the same time. However, the objective should then be to reflect in its financial report the benefits that each entity has.
34 IASB *Framework*, paragraph 49.
35 CON 6, paragraph 25.
36 The Australian, Canadian, German, Japanese, New Zealand, and UK definitions all feature control also.

What Does Control Mean?

35. The IASB *Framework* briefly discusses control, noting that it usually results from legal rights, but may arise in other ways. In the latter regard, it cites the example of know-how obtained from a development activity when, by keeping that know-how secret, the entity controls the benefits that are expected to flow from it.[37] CON 6 contains a similar discussion, noting that, "although the ability of an entity to obtain benefit from an asset and control others' access to it generally rests on a foundation of legal rights, legal enforceability of a claim to a benefit is not a prerequisite for a benefit to qualify as an asset if the entity has the ability to obtain and control the benefit in other ways."[38,39] Thus, there seems to be agreement that control goes beyond legal rights and includes the ability to obtain and control the benefit in other ways, including restricting, or otherwise discouraging, the access of others to the asset (for example, keeping the know-how secret). The Australian framework goes on to specify that possession of an object or right is not necessarily synonymous with control.[40] As an example of this aspect of the definition, satisfied customers would not meet the definition of an asset of an entity because the entity has no legal rights and cannot deny others the ability to entice away customers. However, a customer list would meet the definition, as the owner can deny others access to that list.

What Does the Entity Control?

36. Once we understand what control means, we need to consider what the entity has control of. This is cross-cutting issue EL3: "*What is controlled—the resource/right that gives rise to future economic benefits or the future economic benefits themselves?*"

37. On this point, the IASB and FASB definitions differ. The FASB definition[41] takes the view that it is the future economic benefit that is controlled. However, the IASB takes the view that a resource is controlled, from which future economic benefits flow.[42]

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37 IASB *Framework*, paragraph 57.
38 CON 6, paragraph 26.
39 The Australian, Canadian, German, New Zealand, and UK conceptual frameworks also incorporate this type of discussion.
40 Australian Statements of Accounting Concepts, SAC 4,*Definition and Recognition of the Elements of Financial Statements*, paragraph 14.
41 As does Australia and New Zealand.
42 Canada also refers to assets as economic resources from which future economic benefits may be obtained.

38. The IASB view is more compatible with the definition that we have been developing so far—an existing economic resource with the ability to generate economic benefits. It is not the economic benefits that represent an asset. Rather, the asset is the existing economic resource that has the ability to generate economic benefits.[43] Accordingly, we think that what is controlled is the resource that gives rise to economic benefits, rather than the economic benefits, themselves.

Is Control Needed?

An Alternative—Rights or Other Access

39. Do we need control in the definition of an asset? Is control the best notion? Cross-cutting issue EL1 asks, "*Should assets be defined in terms of rights or resources? E.g., securitisation—selling rights to future revenues, but those rights are not recognised.*"

40. The UK SOP defines assets as "…rights or other access to future economic benefits controlled by an entity as a result of past transactions or events."[44] While this includes control, perhaps the more interesting aspect of the definition to explore for a moment is the idea of "rights or other access." The UK definition takes the view that the asset is neither the item of property nor the future economic benefits. Rather, it is the "rights or other access" to some or all of the future economic benefits derived from the item of property.[45]

41. This seems to be a more useful notion in a world where access rights can increasingly be carved up and distributed between individuals, as in the securitisation example in cross-cutting issue EL1. As another example, the Australian conceptual framework cites lease agreements that unbundle the future economic benefits embodied in leased property by giving the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value.[46] Rights seem to work better than control in this example too, since the entity has legal rights to future cash flows arising from the resource, but does

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[43] Davies and Davies point out in their article "What is an Asset," Part II, *Certified Accountant*, August 1996, that while an enterprise may have rights or other access to property, no business possesses rights or other access to future economic benefits, which have to be fought for in the marketplace.
[44] UK SOP, paragraph 4.6.
[45] UK SOP, paragraph 4.8.
[46] Australian Statements of Accounting Concepts, SAC 4, paragraph 23.

not have ownership or control of the resource itself. Rights also seem to work better when one cannot control the actions of another party, but there is some right to a benefit if the other party takes particular actions, such as in the case of renewal options.[47]

42. In some cases, control might create rights. For example, in some jurisdictions an individual that controls property through possession might, after some period of time, acquire rights to that property. Even though control might have a role on determining rights, we think that the focus on rights is preferable to control.

43. The UK SOP discusses shared rights as follows: "On the other hand, a single item of property may give rise to assets of more than one entity. If two entities control the rights to different future economic benefits from the same item of property, both entities will have an asset (subject to the other aspects of the definition being met). However, although the item of property underlying the asset will be the same, the assets will be different because the future economic benefits are different. For example, if an entity leases an item of property to another entity, both entities will recognise an asset based on rights relating to the leased item of property although, as the lessor's rights will not be identical to the lessee's, the assets will not be the same."[48]

44. The UK SOP explains that one needs more than just a right/entitlement.[49] One also needs to include "other access." For example, an entity may have no legal rights to secret know-how, or an unpatented invention, but can restrict, or otherwise discourage, others' access.[50] This is similar to the aspect of control discussed in paragraph 35, above—that the ability to restrict others' access also creates an asset of an entity. This would need to be explained in supporting material.[51]

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47 We intend to explore renewal options and other similar rights in more detail in February 2006.

48 UK SOP, paragraph 4.20.

49 UK SOP, paragraph 4.12.

50 A recent *Fortune* magazine article discusses trading in virtual items in on-line gaming, whereby participants accumulate digital images (to which they have no legal right) and are able to trade them in hard currency to make them available to other game participants. The ability of the participants accumulating the scarce resources to prevent other's access to those resources creates the first part of an asset to those participants. (see "From Megs to Riches", *Fortune*, November 28, 2005.)

51 It might be considered unnecessary to include the words "or other access" in the definition. The supporting material could explain that "rights" do not only constitute legal rights, but also encompass other access. However, on balance we think it is clearer to include these words directly in the definition.

45. We think that "rights or other access" is a more useful notion and recommend that it be introduced.[52] However, before building the working definition one more step, we would add one more aspect. If we refer only to "rights or other access" to something, we are not specifying at what time those rights or other access must arise. The possibility would arise that one could recognize as assets rights or other access that do not exist, but will, or are expected to, arise a long time into the future. Therefore, we also recommend that we borrow a word from today's definition of a liability and specify that the rights or other access must be <u>present</u> at the balance sheet date—i.e., the term we will introduce into our definition is *present rights or other access*. This also has the benefit of helping to align, more closely, the definitions of assets and liabilities.[53] We also propose to specify at this point, as we are now considering an asset "of an entity" that the favourable cash flows must flow "to the entity."

46. Thus, our proposed working definition of an asset form paragraph 29 becomes:

> An asset <u>of an entity</u> is <u>a present right, or other access, to</u> existing economic resources with the ability to generate economic benefits to the entity.

If We Introduce Rights or Other Access, Do We Also Need Control?

47. Even though the UK SOP definition of an asset introduced the notion of "rights or other access," it also retained the need for those "rights or other access" to be controlled by the entity. It is not clear that this adds anything significant to the definition. If an entity has a present right, or other access, that would seem to be sufficient to establish the fact that the asset is an asset of that entity. Indeed, if an entity has exclusive rights, it presumably can deny or regulate access to that benefit by others.

48. Shared rights (or other access) would seem capable of being dealt with in a manner similar to the manner in which they are dealt with today. As the Australian Statement of

52 Samuelson, R.A., in "The Concept of Assets in Accounting Theory", *Accounting Horizons*, Vol. 10 No. 3 September 1996, also argues for assets to be defined as property rights—the rights to use resources, noting that this also results in the elimination of deferred costs that are not rights to use wealth and, thus, improving the understandability, relevance, and comparability of financial statements.

53 We think that it will be preferable to align the definitions of assets and liabilities to the extent possible. An implication of this view is that we might need to reconsider certain aspects of the definition of an asset once we have considered the definition of a liability.

Accounting Concepts, SAC 4 notes, "…future economic benefits expected from objects or rights may, by virtue of specific business arrangements, be shared by more than one entity. For example, each party to a joint venture may have an interest, as tenant in common, in each of the objects or rights committed to the joint venture and may possess assets comprising their respective shares of the objects or rights. Also, lease arrangements unbundle the future economic benefits embodied in leased property by giving the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value."[54] The UK SOP acknowledges a similar situation and notes that each entity would recognize an asset based on the rights that it has.[55]

49. We think that if we introduce a requirement for an entity to have "present rights or other access" we do not need to also require that an entity have control of those present rights or other access—at least not in the asset definition.

50. One might wonder whether this opens the possibility that an entity would include a right to use a public facility—such as a right of way, or a public library. However, in these cases, the economic resource to which the entity has access is not scarce—all other members of the public also have access to that economic resource.

51. The conclusion in paragraph 49 does open the possibility that an entity might recognize an asset representing rights to such things as reputation in the market place, or customer relationships. However, the question here may be whether those rights can be reliably measured, and hence recognised, rather than whether they constitute an asset in the first place. That is a question we will leave until we consider recognition.

Other Considerations Relating to Control

52. Before we leave the discussion of control, two other aspects might be considered.

53. Cross-cutting issue EL6(a) asks, *"Does control belong in the asset definition or should it be part of the recognition criteria?"* We have proposed, so far, that control does not have a role in the definition of an asset—rather we have replaced it with present rights or other

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54 Australian Statements of Accounting Concepts, SAC 4, paragraph 23
55 UK SOP, paragraph 4.20.

access. Control is concerned with whether the rights or other access to economic benefits belong to the entity. If our objective is to define "assets of an entity" then it seems necessary to include something that associates the asset to the entity. The alternative would be to define an asset in general terms and only deal with whether a particular asset should be recognized by the reporting entity in recognition criteria. We think that it is preferable to include an aspect of associating the asset with the entity in the asset definition.

54. Another issue is whether an entity needs to obtain <u>or</u> control or obtain <u>and</u> control? The definition in CON 6 specifies that it is sufficient to obtain <u>or</u> control. However, in paragraph, 26, it goes on to state that an essential characteristic of an asset is that "…a particular entity can obtain the benefit <u>and</u> control others' access to it…" (emphasis added). We think that it is unnecessary to refer to both "obtain" and "control" and suggest that if control were to be used in the definition of an asset, that would be sufficient on its own, without also specifying that it is necessary for the entity to be able to obtain the benefits.

Essential Characteristics of Assets: Past Events

55. Both the IASB and FASB definitions of an asset include the fact that an asset arises as a result of past (transactions or) events.[56] The IASB *Framework* explains this aspect of the definition as follows:

> The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.[57]

56. This aspect does not seem essential in our proposed working definition. The method of acquisition of rights or other access does not affect whether the item under consideration meets the essential characteristics of an asset at the present time. References to "past events" seem to have been included in definitions so as to exclude the future.[58] However, if

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[56] The Australian, Canadian, German, Japanese, New Zealand, and UK definitions all include this fact as well.
[57] IASB *Framework*, paragraph 58.
[58] The December 2, 1976, FASB Discussion Memorandum, "Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement," discusses this in paragraph 127 and

we define an asset to represent "present rights or other access," it seems unnecessary, in addition, to specify that there must have been a past transaction or event.[59] Those rights or other access must exist today — so they can't be ones that will not arise until the future. Equipment to be acquired next year does not give rise to a present right to that equipment. However, if it is a firm commitment, it might give rise to something of value — with the ability to generate favourable cash flows — so that there might be an asset representing a favourable contract, rather than the equipment.

57. We think that if we are to adopt a clear and concise definition of an asset, every word should count. Therefore, we think it unnecessary to include a requirement for there to be a past transaction or event in the definition of an asset.

58. We note that, if the Boards prefer to keep the notion of a past transaction or event, we think it would be better to refer to either "a past event," or "a past transaction or other past event" to reflect the fact that a transaction is, itself, a past event.

59. Cross-cutting issue EL7 asks, "*What is the event that results in an asset being 'obtained or controlled' by an entity?*" In the working definition in this paper, this question becomes less significant. As discussed above, if the essential criterion is whether an entity has a "present right or other access," then consideration as to what the event is that gave rise to that present right or other access is not essential to the definition of an asset[60]. Usually, the terms of legal contracts and other contractual agreements, such as those underlying property transfers and financial instruments, establish when one entity gives up rights and another entity takes on rights. For example, a shipping contract usually specifies when title passes.

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makes reference to this view being expressed by Sprouse and Moonitz in AICPA ARS No. 3, *A Tentative Set of Broad Accounting Principles for Business Enterprises,* pp. 20 and 21.

59 This view is also acknowledged in the FASB Discussion Memorandum referred to in the previous footnote. Hendriksen, Eldon S., and van Breda, Michael F, *Accounting Theory*, Fifth Edition, 1992, page 456 also express the view that, "the necessity of the (past transaction or events) criteria is arguable because if economic benefits do exist and are under the control of the entity, they must have arisen from some past event." They continue to note that, "there is a strong pragmatic case to be made for including some estimate of the value of resources such as Mickey Mouse on the balance sheets of the Disney Company—despite the lack of a transaction."

60 However, it will be essential in considering when the asset is recognised – to be considered when we look at recognition, later in this Phase of the project.

60. A more significant issue might seem to exist with internally generated assets. However, even here, the entity should be able to assess at a reporting date whether it has something with the ability to generate favourable cash flows and for which it can restrict others' access.[61] If that is the case, the entity has an asset (although we might decide when considering recognition that there are certain other criteria that must be met, such as reliable measurement, before we would allow an entity to recognise that asset).

61. The question of what the event is that gives rise to an asset has been illustrated in the past by the example of a lottery ticket. Some think that the purchase of the lottery ticket is the event giving rise to an asset, whereas others think that an asset does not exist until the ticket holder wins the drawing. We think that by focusing on present rights in the working definition of an asset, as recommended in this paper, it is clear that, on purchasing the lottery ticket, the purchaser has a right to an economic resource that is capable of generating economic benefits to the entity—the right to participate in the draw. One does not have to ask what the past event was.

62. Another example is that of an oil exploration company that has spent money drilling a well to explore for oil reserves. Like in the lottery ticket example, some have questioned whether the event giving rise to an asset is the acquisition of the lease that allows the company to drill for oil, or the finding of oil. Under the working definition, this issue is not as significant. Once the entity has the right to drill for oil (the lease) it has a right with the ability to generate favourable cash flows to the entity. It has an asset. It does not have to question what the past event is (or what the likelihood of finding oil is).

63. It is worth noting that the examples in the previous two paragraphs highlight the need to be very clear as to what the asset is – i.e., in paragraph 61, the right to participate in the drawing, rather than the right to claim the prize.

Likelihood

64. Both the IASB and FASB definitions include some degree of likelihood in the definition of an asset. The IASB definition states that, "… future economic benefits <u>are expected</u> to flow

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[61] It might even have established legal rights by way of trademark, copyright, or similar agreement.

to the entity."[62] The FASB definition states that, "Assets are probable future economic benefits …."[63] Only the Canadian definition includes a similar notion ("may be obtained"). The Australian, German, Japanese, New Zealand, and UK definitions do not include any degree of likelihood in the definition of an asset.

65. The inclusion of likelihood in the definition of an asset by the FASB and the IASB has caused many difficulties in interpretation. The FASB notes that, "*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 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…."[64] But, this does not seem to have alleviated the difficulties (perhaps no one reads the footnote!). A 1998 FASB Special Report by Reed Storey and Sylvia Storey[65] explains that, "The first Exposure Draft did not contain the word probable. … The Board received many comment letters that said, in essence, "almost nothing can ever be an asset or liability because you have said that it has to be certain, and everything except cash is uncertain." The Board thus inserted "probable" into the definition. … Probable is not an essential part of the definitions; its function is to acknowledge the presence of uncertainty and to say that the future economic benefits or sacrifices do not have to be certain to qualify the items in question as assets and liabilities, not to specify a characteristic that must be present."

66. We think it is unnecessary to include any notion of likelihood in the definition of an asset. We think it is sufficient that the economic resource in question has the ability to generate favourable cash flows to the entity. If there is any question of likelihood to be considered, that might be in assessing whether an asset qualifies for recognition (this will be considered in cross-cutting issue EL12, at a later date) or in measurement — not in the definition of an asset.

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[62] IASB *Framework*, paragraph 49.
[63] CON 6, paragraph 25, footnote reference omitted.
[64] CON 6, paragraph 25, footnote 18.
[65] Storey, Reed and Storey, Sylvia, (January 1998), FASB Special Report, *The Framework of Financial Accounting Concepts and Standards*, page 131.

Working Definition

67. Our working definition from above, is as follows:

> *An asset of an entity is a present right, or other access, to an existing economic resource with the ability to generate economic benefits to the entity.*

68. We have also identified several other aspects of an asset that would need to be explained in supporting material. These include the following:

    (a) Explaining that "other access" includes restriction on others access. (see paragraph 44)

    (b) Explaining what we mean by economic resources—those that are scarce and useful for carrying out economic activities, such as consumption, production, and exchange. (see paragraph 14)

    (c) Explaining that, for business enterprises, the ability to generate economic benefits is the same as the ability to generate favourable cash flows. (see paragraph 28)

    (d) Explaining that the ability to generate economic benefits might operate "singly or in combination with other assets." (see paragraph 31)

    (e) Explaining that control is unnecessary when one has a present right, or other access. (see paragraph 49)

    (f) Explaining that there is no necessity for a past event. (see paragraph 57)

69. This raises a question as to whether we should strive for a relatively brief definition of an asset that is relatively easy to remember, but requires supporting guidance to fully understand it, or a more comprehensive definition that encompasses all essential features? We think that the former is preferable.

70. We also note that the IASB defines "an asset" (singular), while the FASB defines "assets" (plural). We understand that the FASB may have adopted that approach for ease of drafting. Do Board members have any preference as to whether they think we should use singular or plural?

SUMMARY OF STAFF RECOMMENDATIONS

Working definition of an asset:

> An asset of an entity is a present right, or other access, to an economic resource with the ability to generate favourable cash flows to the entity.
>
> Supported by material explaining that:
>
> (a) "other access" includes restriction on others access. (see paragraph 44)
>
> (b) "economic resources" are scarce and useful for carrying out economic activities, such as consumption, production, and exchange. (see paragraph 14)
>
> (c) for business enterprises, "the ability to generate economic benefits" is the same as the ability to generate favourable cash flows. (see paragraph 28)
>
> (d) the ability to generate economic benefits might operate "singly or in combination with other assets." (see paragraph 31)
>
> (e) control is unnecessary when one has a present right, or other access. (see paragraph 49)
>
> (f) there is no necessity for a past event. (see paragraph 57)

EL1: Should assets be defined in terms of rights or resources? E.g., securitisation—selling rights to future revenues, but those rights are not recognised.

We think that "rights or other access" is a more useful notion and recommend that it be introduced. (see paragraph 45)

EL3: What is controlled—the resource/right that gives rise to future economic benefits or the future economic benefits themselves?

We think that what is controlled is the resource that gives rise to economic benefits, rather than the economic benefits, themselves. (see paragraph 38)

EL6(a): Does control belong in the asset definition or should it be part of the recognition criteria?

We think that it is preferable to include an aspect of associating an asset with the entity in the asset definition. (see paragraph 53)

EL6(b): Is it preferable to have a broad set of assets at the elements level that is refined at the recognition level?

We think it preferable to reserve the right to conclude that certain things that meet the definition of an asset for accounting purposes might, nonetheless, not be recognized for practical reasons. (see paragraph 21)

EL7: What is the event that results in an asset being "obtained or controlled" by an entity?

In the working definition in this paper, this question becomes less significant. If the essential criterion is whether an entity has a "present right or other access," then consideration as to what the event is that gave rise to that present right or other access is not essential to the definition of an asset. (see paragraph 59)

EL8: Are accounting assets different from economic assets? If so, why?

We think that accounting assets include all economic resources, but only if economic resources are defined in a manner to restrict them to those that are scarce and useful for carrying out economic activities, such as consumption, production, and exchange. (see paragraph 14)

APPENDIX A

Cross-Cutting Issues Remaining to Be Addressed

EL2: What does control mean, e.g., insurance renewals—don't control person paying premium but can restrict others access to it. [Scheduled for February 2006]

EL4: Are above questions related to a difference between control and compel? E.g., loans—can compel repayments; other assets—cannot compel but if counterparty chooses to pay then those payments are made to the entity. [Scheduled for February 2006]

EL5: Which future economic benefits are included—where does asset end? [Scheduled for February 2006]

EL9: What about "stand-ready" assets—opposite of "stand-ready" liabilities? [Scheduled for February 2006]

EL10: Why is internally generated goodwill not recognised—does this relate to the asset definition or recognition criteria? [Scheduled for February 2006]

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 (pg 19)[66]	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.

[66] *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.

APPENDIX C:

Assets

This appendix identifies a number of things that some consider assets, some of which are recognized and others that are not recognized. It includes not only assets that might be considered by private business entities, but also certain public sector assets. The intent of the appendix is to provide a list of assets that might be considered when testing the ideas presented in the main body of this paper.

- **Cash—**coins, paper currencies, etc.
- **Financial assets—**cash, contractual right to receive cash or another financial asset or exchange, equity instrument.
- **Taxation receivable—**right to receive, not a contractual right, similar rights obtained under contract—may not be an asset as not subject to formal agreement, depends on interpretation of control and past event (while more significant to public sector entities, private sector entities nonetheless may have expectations of recovering taxes under statutory, rather than contractual, rights).
- **Physical assets**
    - **Inventories.**
    - **Long-term—**plant, buildings.
    - **Infrastructure—**long-life major assets, e.g., roads, bridges, communication networks, sea defences, footpaths.
        - UK definition—expenditure of capital nature on an immobile specialised asset, which is recoverable only if continued use of asset created, no realisable value or earning potential; sunk costs, cannot be reasonably expected to have alternate use than what it was created for.
        - New Zealand—stationary physical assets which form a network to facilitate delivery of goods and services.
- **Heritage assets—**physical assets the community intends to preserve because of cultural, historic, or environmental reasons; preserve indefinitely, e.g., monuments, art, museums, historical treasures.
- **Community assets—**local authority holds in perpetuity, no determinable useful life, have restrictions on their disposal, e.g., parks or historic buildings.
- **Defence assets**
    - UN distinguishes from gross fixed capital formation—outlays for military purposes on land and certain civilian uses, e.g., schools, hospitals, family-type housing, military airport.
    - UK—Military hardware, excluding buildings, depots, land; separate given speed of technological development and change is rapid that reliable measurement is impossible, e.g., tanks, planes, and warships are current expenditure.
- **Natural resources**
    - (1989 Canadian description) economic resources in their natural undeveloped state—further categorized.

        - **Renewable—**natural resources that can be developed and managed to produce sustainable yield for an indefinite long period, e.g. farm land, forests, fish stocks, water for electricity generation.
        - **Depletable—**petroleum and mineral deposits that will diminish to the point of exhaustion over the period of their production.
        - Both need to be managed to provide a sustainable yield, otherwise renewable can be depletable.
- **Intangible assets**
    - **Identifiable—**sold or acquired separately from other assets; include rights created by virtue of legislation but are unconnected to natural resource use, patents, databases and concessions.
    - **Non-identifiable—**all others; cannot be sold separately, include goodwill, human resources, power to tax.
    - Might include patents, copyrights, franchises, trademarks, computer domain names, unpatented technology, technical drawings, databases, research and development, customer lists, medical records, financial institution depositor and other customer relationships, customer routes or territories, etc.

Sources: IFAC, Public Sector Study & FASB Statement No. 141, *Business Combinations*

Others:
- Commodities.
- Rights (identifiable intangible).
    - Right of way.
    - Lease, indefeasible right to use (IRU—telecommunication asset or expense).
    - Digital images (“virtual items” or “graphical manifestations”).

APPENDIX D

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