Financial Accounting Standards Board

Board Meeting Handout

HYBRID FINANCIAL INSTRUMENTS

December 14, 2005

At today's meeting, the Board will discuss the remaining issues identified in the comment letters on the Exposure Draft, *Accounting for Certain Hybrid Financial Instruments*. Specifically, the Board will discuss the following issues:

***Issue 1*—Transition**

Due to the recent decision to allow an instrument-by-instrument adoption of the fair value option for existing hybrid instruments, the interaction between the Exposure Draft and the recently posted FSP 133-a needs to be considered. This adoption may result in a transition adjustment for hybrids that are subject to Implementation Issue B6. That is, the aggregated carrying amount of bifurcated host contracts and embedded derivatives could be different than the fair value of the combined hybrid. How this transition amount is recognized could be handled in one of three ways:

> ***Alterative A***—Require adoption of all three standards (the hybrids Statement, the fair value measurement Statement, and FSP FAS 133-a) simultaneously.
>
> ***Alternative B***—Require that any cumulative effect resulting from electing the fair value option for existing bifurcated hybrids be accounted for consistent with current guidance established in EITF Issue No. 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*.
>
> ***Alternative C***—Allow early adoption in any quarter in a fiscal year prior to the required effective date as long as prior quarters were retrospectively adjusted to show the effect of the change as of the beginning of the fiscal year (similar to a voluntary, preferable change in accounting principle under Statement 154).

The staff recommends Alternative B. This alternative provides a transition and effective date that would allow for adoption of the hybrids Statement before adoption of the fair value measurement Statement and FSP FAS 133-a by applying the criteria in Issue 02-3 for recognition or deferral of any transition adjustment. The staff believes that requiring adoption of all three standards at the same time would generally preclude entities from adopting the hybrids Statement this year (either because preparers are not capable of early adopting the fair value measurement Statement or because the Board is delayed in issuing it or FSP FAS 133-a in time for entities to adopt in their first fiscal quarter).

Issue 2—Beneficial Interests as Interests from Qualifying SPEs Only

Respondents frequently commented on the definition of a beneficial interest. A number of respondents requested that the Exposure Draft clarify whether a beneficial interest can only be issued by a qualifying SPE.

The staff recommends that the term *beneficial* be eliminated from the proposed Statement to clarify that the references were generic in nature rather than specific to beneficial interests as defined in the transfers Exposure Draft.

Issue 3—Derivatives and Qualifying SPEs

Respondents were also mixed in their responses to the question of whether or not the requirements for evaluating and accounting for interests issued by qualifying SPEs are clear and understandable.

Statement 140 Paragraph 40(c)

Regarding subparagraph (c) of paragraph 40, respondents specifically questioned whether a credit default swap in conjunction with highly rated debt can be held by a qualifying SPE in which the purpose of the credit default swap is to introduce a specific risk into the structure that is passed on to the beneficial interest holders in the qualifying SPE.

The staff recommends modifying paragraph 40(c) to clarify that holding passive derivative instruments that create risks within a structure through impacts on the cash flows available to beneficial interests issued should not disqualify an otherwise qualified SPE.

Statement 140 Paragraph 35(c)

However, in response to concerns that an embedded derivative identified in a beneficial interest issued by a qualifying SPE might not (or would not) be considered a permitted holding of a qualifying SPE, the staff notes that the discussion of embedded derivatives in beneficial interests has focused on those entities holding such interests rather than on the accounting for the qualified SPE issuing the interest. While separate financial statements for qualifying SPEs many times are required (by trust documents, etc.), it is the staff's view that the accounting by the qualifying SPE (and the potential identification of embedded derivatives in the interests issued by the qualifying SPE) should not impact the qualified status of the SPE.

The staff believes that paragraph 35(c) of Statement 140 was intended to identify the instruments a trust could hold (as contrasted with interests the trust might be a party to through its capacity as issuer of interests) and therefore no action is required regarding this recommendation.

***Issue 4*—Application to Issuer**

In response to a request for clarification of whether the fair value election guidance in the Exposure Draft is intended to apply to both issuers and holders of hybrid financial instruments, it is the staff's belief that the Board intended the Exposure Draft to apply to issuers as well as holders of hybrid financial instruments, as demonstrated by discussions of possibly disqualifying qualifying SPEs. In that regard, the staff recommends adding a sentence at the end of paragraph 16 as follows: "Both hybrid financial instruments that are *purchased as well as those that are issued* are eligible for the fair value measurement election."

***Issue 5*— Significance of Embedded Derivative**

One respondent raised the concern that entities would effectively be able to carry their debt at fair value by embedding a derivative feature therein that would be required to be separated under the requirements of Statement 133, even if the embedded feature has little significance relative to the overall instrument.

The staff does not recommend a change to the Exposure Draft, as it does not believe it appropriate to introduce a significance test to Statement 133 where one has never existed before.

***Issue 6*—Recognized Financial Assets and Assessment for Embedded Derivatives**

Several respondents commented that the guidance in the Exposure Draft is unclear as to 1) whether a financial instrument must be recognized in order to qualify for the fair value election provided in the Exposure Draft and 2) whether only an initial assessment for the existence of an embedded derivative is required or if a continuous assessment is required.

The staff believes that there may be instances not contemplated at this time that could give rise to the question of whether the requirements of the Exposure Draft are applicable to unrecognized financial instruments. Accordingly, the staff recommends that clarifying language be included in the proposed Statement, which excludes from its scope unrecognized financial instruments and that the terminology *inception* be changed to *first acquired, issued, or modified.* The staff believes this clarification is consistent with the Board's original intent.

Additionally, the staff notes that the concept of continuous assessment is not explicit in Statement 133 but is implied in several places. However, the staff also notes that the specific instance in which Statement 133 states that a continuous assessment is not required (paragraph 15) is the same instance in IAS 39, paragraph AG33(d), requiring continuous reassessment. Further IFRIC Draft Interpretation D15 clarifies that the bifurcation analysis is meant to be a one-time event that only takes place at inception.

The staff believes that in most situations involving managed CDOs or other managed structures, the terms of the interests issued will continue to provide sufficient information to determine whether the interest is a derivative or whether it contains an embedded derivative requiring bifurcation. The staff does not believe this project is the appropriate forum to address whether the evaluation for embedded derivatives is a continuous test or only an initial test and recommends that the Exposure Draft not be changed to address this issue.

***Issue 7*—Interaction with Implementation Issue B39**

Several respondents questioned whether different accounting should result when a prepayment option is present in an instrument that, if held directly, would not result in identification of an embedded derivative based on Implementation Issue B39. However, the same instrument, issued through a securitization structure, would result in the identification of an embedded derivative based on the guidance in Example 6 of Implementation Issue B39.

The staff recommends including changes in the proposed Statement that would specify that pro rata securitization interests (participations), or guaranteed mortgage securitizations, in pre-payable mortgage loans would consider the prepayment option clearly and closely related to the debt host as established in Implementation Issue B39.

***Issue 8*—Disclosure**

At the request of several Board members in the December 8, 2005 education session, the staff has provided several alternative disclosure possibilities for inclusion in the hybrids Statement.

> ***Alternative A*—**Require separate balance sheet presentation of elements measured at fair value. That is, to the extent that loans or debt included hybrid instruments in which the fair value election had been applied, amounts in these balance sheet captions would have to be separately presented from balances measured at amortized cost. This disclosure would apply to any balance sheet caption that included hybrids where the fair value option was elected.
>
> ***Alternative B***—Require parenthetical disclosure on the face of the balance sheet for each caption including hybrid instruments in which the fair value election had been applied. This would have the same effect as the first alternative except in parenthetical form.
>
> ***Alternative C***—Require aggregation of all asset hybrid financial instruments in which the fair value election has been applied in one line on the balance sheet. In addition, require footnote disclosure to provide detail of the captions in which the amounts would have been recognized had the fair value election not been applied. This aggregate presentation would also be required for liabilities.
>
> ***Alternative D***—Require footnote disclosure only. In this approach, a single amount would be disclosed for assets and a single amount disclosed for liabilities measured at fair value as a result of the election to account for the hybrid at fair value.

In conjunction with the fair value measurement project, several constituents complained that the Board's approach to fair value and financial instrument disclosures is piecemeal and results in conflicting or incomplete presentations of information. The staff agrees with these constituents and continues to recommend that the hybrids Statement not require any incremental disclosures.

Issue 9—Additional Comments

The following are additional comments that the staff believes do not require the Board's consideration at this time.

1. ***Failed Sales*—**Requests for additional guidance regarding the accounting asymmetry between liabilities associated with a transaction that does not meet the sale accounting criteria and the assets related to those liabilities.
2. ***Multiple Recognition of Assets***—Questions have been raised about paragraph A22 of Statement 140 in relation to purchaser recognition of interests in a transfer that fails to meet the requirements for a sale and the possibility that the assets could be recognized on the books of both the purchaser of the interests and the transferor.
3. ***Other Affected Literature***—One respondent noted additional accounting literature that may be affected by the proposed guidance in the Exposure Draft that was not listed in the appendix.
4. ***Definition of Payoff Structure***—One respondent requested that the term *payoff structure* be defined in the Exposure Draft, as they do not believe it is sufficiently understandable in the context presented.

Next Steps

Assuming the Board is able to reach decisions on the issues raised in this memo, the staff believes there are no remaining issues to consider in redeliberations. As such, the staff will proceed to incorporate changes resulting from redelibrations and submit a staff draft for the Board's consideration. After receiving and incorporating comments from the Board in the staff draft, the resulting external review draft will be provided to external reviewers (generally the public accounting firms and certain interested preparers who commented on the Exposure Draft) for fatal flaw comments. The staff believes that a final Statement could be ready for publication on or around January 31, 2006. The staff asks for the Board's concurrence to proceed to a staff draft.

Board Meeting Handout
Fair Value Option and Servicing of Financial Assets
December 14, 2005

The Board will consider whether to prohibit the aggregation of heterogeneous amounts (specifically, fair value and non-fair-value amounts) in the statement of financial position. The discussion will address those fair value amounts resulting from the optional election of the fair value subsequent measurement attribute.

At its December 7, 2005 fair value option (FVO) meeting, the Board decided that for the financial assets and financial liabilities that are reported at fair value pursuant to the FVO election, fair value carrying amounts should not be aggregated on the statement of financial position with non-fair-value carrying amounts of similar financial assets or similar financial liabilities. Consequently, the statement of financial position would need to present two separate line items for those similar financial assets or similar financial liabilities.

In the life settlements project, the Board similarly decided to prohibit aggregating fair value carrying amounts with non-fair-value carrying amounts. Thus, separate line items must be presented on the face of the statement of financial position for life settlement contracts reported at fair value and life settlement contracts reported under the investment method.

However, in three other projects/standards that permit the elective use of an FVO, with changes in fair value reported in earnings, such aggregation is not prohibited, as noted in the chart below:

Projects/Standards Permitting Elective Use of Fair Value	Balance Sheet Aggregation of Fair Value Carrying Amounts with Non-Fair-Value Carrying Amounts	
	Prohibited	Not Prohibited
FVO Project (Item-by-item election)	**X**	
Life Settlements FSP Project (Item-by-item election)	**X**	
Servicing Rights Project (Election by class)		**X**
Hybrid Financial Instruments Project (Item-by-item election)		**X**
Statement 115 (Item-by-item classification in the trading category)		**X**

The Board will discuss whether that potential for inconsistency in the display requirements for the statement of financial position should be eliminated. Eliminating that inconsistency could lead to changes to the display provisions of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and the forthcoming guidance for servicing rights.

The staff supports eliminating that inconsistency in the presentation in the statement of financial position.

Financial Accounting Standards Board

Board Meeting Handout

POSTRETIREMENT BENEFIT OBLIGATIONS INCLUDING PENSIONS

December 14, 2005

PURPOSE

At the December 14, 2005 meeting, the Board will discuss proposed changes in financial reporting by employers that sponsor defined benefit pension and other postretirement plans. The proposed changes are part of the first phase of the comprehensive project on employers' accounting for postretirement benefits. The objective of phase 1 is to improve financial reporting by requiring that the over-funded or under-funded status of postretirement benefit plans, measured as the difference between the fair value of plan assets and the benefit obligation (that is, the projected benefit obligation (PBO) for pensions and the accumulated postretirement benefit obligation (APBO) for other postretirement benefits), be recognized on the balance sheet.

STAFF RECOMMENDATIONS

Following is a description of the staff's recommendations for the objectives and scope of phase 1 and how the over-funded or under-funded status of defined benefit postretirement plans would be recognized in the balance sheet. The accounting for tax effects, if any, of the proposed changes will be addressed at a subsequent meeting.

Item 1: Objectives and Scope of Phase 1

The staff's intent is to propose recommendations that are consistent with the objectives and scope of the initial phase of the project discussed at the November 10, 2005 agenda decision Board meeting. The staff believes the objectives and scope of phase 1 are as follows:

a. Improve the reporting of employers' obligations for pensions and other postretirement benefits (for example, making amounts recognized in the balance sheet more understandable) by recognizing the over-funded or under-funded status of defined benefit postretirement plans as an asset or a liability. This includes recognizing all previously unrecognized items, even when the plan is fully funded.

b. Not to change how plan assets and benefit obligations are measured under Statements 87 and 106. The asset or liability would be measured as the difference between the fair value of plan assets and benefit obligations (that is, the PBO for pensions and the APBO for other postretirement benefits).

c. Not to change the basic approach for measuring the amount of annual net benefit cost reported in earnings.

d. Implement phase 1 improvements as quickly as possible with a goal of making them effective for years ending after December 15, 2006.

Item 2: Measurement Date

The staff recommends eliminating the provisions in FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, E*mployers' Accounting for Postretirement Benefits Other than Pensions*, that permit plan assets and obligations to be measured as of a date not more than three months prior to the reporting date. The staff recommends requiring measurements to be as of the reporting date. The staff believes that the effective date of this change should be one year later than the effective date of the other changes adopted in phase 1. Effective dates and transition will be discussed at a subsequent Board meeting.

Item 3: Interim Period Financial Statements

The staff recommends no changes in the accounting for defined benefit plans in interim period financial statements.

Item 4: Previously Unrecognized Items

a. **Unrecognized Actuarial Gains or Losses**

The staff recommends that previously unrecognized actuarial gains or losses be recognized in other comprehensive income (OCI). Gains or losses recognized in OCI would be recycled out of OCI into earnings based on the amortization and recognition requirements in Statements 87and106.

b. **Unrecognized Prior Service Costs or Credits** (that is, costs resulting from plan amendments that increase benefits or credits resulting from plan amendments that reduce benefits)

The staff recommends that a net intangible asset be recognized to the extent that prior service costs have not previously been recognized in earnings.

The staff recommends that a net negative intangible asset be recognized to the extent that prior service credits have not been recognized in earnings.

Prior service costs and credits would be classified in the balance sheet as a net intangible asset or net intangible negative asset on an aggregate basis for all plans. Prior service costs or credits would be recycled into earnings based on the amortization requirements in Statements 87 and 106.

c. **Unrecognized Net Transition Assets or Obligations** from the initial adoption of Statements 87 and 106 not recognized in earnings

The staff recommends that the unrecognized net transition asset or obligation be recognized as an adjustment of retained earnings. Those amounts would not be subsequently recognized in earnings.

Item 5: Balance Sheet Aggregation, Classification, and Display

a. **Aggregation of Plan Assets or Liabilities Recognized in the Balance Sheet**

The staff recommends that an entity recognize an asset for over-funded plans and a separate liability for under-funded plans.

b. **Current/Noncurrent Classification of Amounts Recognized in the Balance Sheet**

The staff recommends that Statements 87 and 106 more clearly articulate the present requirement to recognize the current and noncurrent portions of the assets and liabilities recognized for postretirement benefits.

c. **Balance Sheet Display**

The staff does not recommend requiring separate line item presentation of amounts recognized in the balance sheet. Amounts recognized in OCI would be subject to the separate presentation requirements of FASB Statement No. 130, *Reporting Comprehensive Income* (that is, classified based on the nature of the item).

Financial Accounting Standards Board

Board Meeting Handout
Conceptual Framework

December 14, 2005

At today's meeting, the Board will discuss matters related to (a) costs and benefits, (b) the definition of an asset, and (c) the reporting entity. Following is an overview of the issues that the Board will address for each topic.

FASB MEMO 18 (IASB AGENDA PAPER 2)—QUALITATIVE CHARACTERISTICS 6: COSTS AND BENEFITS

1. The Board will continue its discussions of the qualitative characteristics of accounting information, focusing on the pervasive constraint that benefits of an accounting standard should justify the costs involved. The staff has identified three alternatives for conceptual language about costs and benefits:

   a. **Very Little Change from Present Concepts—**Information about benefits, in particular, and costs is difficult to obtain and likely to be incomplete. For these reasons it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard setters should continue to be concerned about the cost-benefit constraint in conducting their deliberations.

   b. **Request More Information—**Standard setters should seek information from preparers, users, and other constituents about their expectations concerning the nature and quantity of benefits and costs of proposed standards. While the information about benefits, in particular, and costs is likely to be incomplete, standard setters should consider in their deliberations the information they can obtain.

   c. **Conduct More Rigorous Cost-Benefit Analysis—**Standard setters should analyze benefits and costs of proposed financial reporting requirements, including (1) seeking information from preparers, users, and other constituents about their expectations concerning the nature and quantity of benefits and costs of proposed standards, (2) taking steps to verify the information received from constituents, and (3) conducting research to develop further necessary information. Standards should require financial reporting information only if expected benefits of that information are shown to exceed the expected costs involved in developing and using the information.

Staff View: Alternative B

2. At the October 25, 2005 meeting, the Boards concluded that there is no need to modify the objectives of financial reporting or qualitative characteristics of decision-useful financial reporting for any types of private sector entities. The Boards acknowledged that there might be differences in how certain qualitative characteristics are applied.

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

At today's meeting, the staff will ask the Board the following question:

1. **Is there a need to modify the cost-benefit constraint for any particular type of entity?**

Staff View: As with other qualitative characteristics discussed in previous meetings, there is no need to modify the cost-benefit constraints for any particular type of private-sector entity. However, there may be differences in how cost-benefit considerations are applied.

FASB MEMO 19 (IASB AGENDA PAPER 2A)—ELEMENTS 1: ASSET DEFINITION

The Board will begin discussing the definition of an asset as part of Phase B: Elements, Recognition, and Measurement Attributes. Refer to the attached Observer Notes for additional information.

The staff will ask the Board the following question:

1. **Does the Board agree with the staff's working definition of an asset (below)?**

   ***Staff View*:** The staff has developed the following working definition of an asset:

   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.

   Supporting material would include the following:

   a. "Other access" includes restriction on other's access.

   b. "Economic resources" are scarce but useful for carrying out economic activities, such as consumption, production, and exchange.

   c. For business enterprises, "the ability to generate economic benefits" is the same as the ability to generate favourable cash flows.

   d. The ability to generate economic benefits might operate singly or in combination with other assets.

   e. It is unnecessary to refer to control in the definition in addition to the requirement that there be a present right, or other access.

   f. It is unnecessary to include reference to a past event in the definition in addition to the requirement that there be a present right, or other access.

FASB MEMO 20 (IASB AGENDA PAPER 2B)—REPORTING ENTITY: PRELIMINARY STAFF RESEARCH

The Board will begin discussing the concept of the reporting entity (Phase D). Neither the FASB's nor the IASB's existing frameworks contain a robust reporting entity concept. However, the existence of that gap in the frameworks does not mean that a reporting entity concept does not exist; an implicit reporting entity concept already exists, and this phase of the project will seek to examine, refine, and clearly articulate that concept.

The staff will ask the Board the following questions:

1. **Does the Board agree with the proposed approach for the reporting entity concept (below)? If not, with which aspects of the approach do Board members disagree?**

   Staff View: The staff proposes that the reporting entity concept be based upon the following approach:

   a. A distinction should be made between an *entity* and a *reporting entity*, such that not all entities are reporting entities. In other words, a reporting entity is drawn from a wider pool of entities, either individually or in combination.

   b. For an organization, arrangement, or structure to be an entity (including a reporting entity), it need not be a legal entity. In other words, the boundaries of an entity should not be limited to legal boundaries. Therefore, what constitutes an entity includes not only legal entities, but other types of organizations, arrangements, or structures, such as sole proprietorships, partnerships, trusts, associations, and group entities.

   c. For an organization, arrangement, or structure to be an entity, it must have the capacity to act, i.e., be able to engage in activities including undertaking transactions with other parties. The capacity to act is not limited to legal capacity (such as the ability to transact in the organization's name rather than the name of its owners). Rather, it simply means that the organization must have some form of management function, which is responsible for conducting or managing the activities of the organization.

   d. The reporting entity concept should be based upon user information needs, i.e., user information needs should be the key determining factor for the purposes of establishing which entities (or combinations of entities) should be identified as reporting entities.

   e. The user information needs referred to in (d) above should be those specified in the objectives of financial reporting.

   f. At a general level, the purpose of consolidated financial statements should be to provide information about the group that is useful to present and potential investors and creditors and other users of the financial reports of the group, in making rational investment, credit, and similar economic decisions.

2. **Does the Board wish the staff to conduct further research into the idea that, for the purposes of drawing the boundary of a reporting entity that comprises a group of entities, the control concept should be supplemented in some way or be a component of a higher level concept?**

Staff View: The staff's above analysis suggests that determining which entities should be combined to form a group entity should be based upon the concept of control, as a minimum. However, further work is needed on the control concept before concluding on this issue. Whether the control concept should be supplemented in some way, or be a component of a higher level concept, is also an open question.

INFORMATION FOR OBSERVERS

IASB Meeting:	**13 December 2005, London (Agenda Paper 2A)**
IASB/FASB Meeting:	**14 December 2005, Norwalk (Memorandum 19)**
Project:	**Conceptual Framework**

Elements 1: Asset Definition

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.

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[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. [Paragraph omitted from Observer Notes]

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." [14] 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 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.[15] 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

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

[15] Recognition will be considered later in this phase of the conceptual framework project.

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.[16] [Remainder of paragraph omitted form observer notes.]

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

    (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.[17] 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

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[16] Nonetheless, information about them may still be included in notes or elsewhere in financial reports.

[17] 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.

the entity."[18] 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…"[19]

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."[20] Furthermore, we have concluded that, "…financial reporting should provide information about the economic resources of the entity (its assets) …"[21] 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."[22] 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.

26. [Paragraph omitted from Observer Notes]

27. [Paragraph omitted from Observer Notes]

28. On balance, we think that we should use the term *economic benefits* rather than *favourable cash flows* in the definition of an asset.[23] Although we think that material supporting the definition of an asset should explain that, for business enterprises, economic benefits are equivalent to favourable[24] cash flows.

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18 IASB *Framework*, paragraph 53.
19 CON 6, paragraph 26.
20 [Footnote omitted]
21 Ibid, paragraph OB20.
22 Ibid, paragraph OB21.
23 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 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. [Remainder of footnote deleted]
24 [Footnote deleted]

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[25] 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 ….[26]

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.

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

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

Essential Characteristics of Assets: Control[27]

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[28] and an entity should not include another entity's assets in its financial report.[29] 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 …"[30] (emphasis added). Similarly, the FASB definition states that "…assets are probable future economic benefits obtained or controlled by a particular entity …"[31] (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.[32] One might ask, however, what control means, what it is that the entity controls, and whether control is needed?

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.[33] 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

27 Issues relating to options over assets will be dealt with at a future meeting.
28 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.
29 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.
30 IASB *Framework*, paragraph 49.
31 CON 6, paragraph 25.
32 The Australian, Canadian, German, Japanese, New Zealand, and UK definitions all feature control also.
33 IASB *Framework*, paragraph 57.

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."[34,35] 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.[36] 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[37] 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.[38]

38. [Portion omitted from Observer Notes] Accordingly, we think that what is controlled is the resource that gives rise to economic benefits, rather than the economic benefits, themselves.

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[34] CON 6, paragraph 26.

[35] The Australian, Canadian, German, New Zealand, and UK conceptual frameworks also incorporate this type of discussion.

[36] Australian Statements of Accounting Concepts, SAC 4,*Definition and Recognition of the Elements of Financial Statements*, paragraph 14.

[37] As does Australia and New Zealand.

[38] Canada also refers to assets as economic resources from which future economic benefits may be obtained.

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."[39] 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.[40]

41. [Paragraph omitted from Observer Notes]

42. [Paragraph omitted from Observer Notes]

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."[41]

44. The UK SOP explains that one needs more than just a right/entitlement.[42] One also needs to include "other access." For example, an entity may have no legal rights to secret know-

[39] UK SOP, paragraph 4.6.
[40] UK SOP, paragraph 4.8.
[41] UK SOP, paragraph 4.20.
[42] UK SOP, paragraph 4.12.

how, or an unpatented invention, but can restrict, or otherwise discourage, others' access.[43] 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.[44]

45. We think that "rights or other access" is a more useful notion and recommend that it be introduced.[45] However, before building the working definition one more step, we would add one more aspect. [Portion omitted from Observer Notes] 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 present 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.[46] 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 of an entity is a present right, or other access, to 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. [Paragraph omitted from Observer Notes]

48. [Paragraph omitted from Observer Notes]

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43 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.)

44 [Footnote omitted]

45 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.

46 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.

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. [Paragraph omitted from Observer Notes]

51. [Paragraph omitted from Observer Notes]

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 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.[47] 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.[48]

56. [Paragraph omitted from Observer Notes]

57. [Portion of paragraph omitted from Observer Notes] …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[49]. 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.

60. [Paragraph omitted from Observer Notes]

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[47] The Australian, Canadian, German, Japanese, New Zealand, and UK definitions all include this fact as well.
[48] IASB *Framework*, paragraph 58.
[49] 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.

61. [Paragraph omitted from Observer Notes]

62. [Paragraph omitted from Observer Notes]

63. [Paragraph omitted from Observer Notes]

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 to the entity."[50] The FASB definition states that, "Assets are <u>probable</u> future economic benefits …."[51] Only the Canadian definition includes a similar notion ("<u>may be</u> obtained"). The Australian, German, Japanese, New Zealand, and UK definitions do not include any degree of likelihood in the definition of an asset.

65. [Paragraph omitted from Observer Notes]

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.

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:

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50 IASB *Framework*, paragraph 49.
51 CON 6, paragraph 25, footnote reference omitted.

(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). [Sentence omitted from Observer Notes] 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)[52]	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.

[52] *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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