

MINUTES



To: Board Members
From: Benson (ext. 446)
Subject: Minutes of the July 26, 2006, Conceptual Framework Board Meeting
Date: July 31, 2006
cc: Leisenring, Bielstein, Smith, MacDonald, Allen, Polley, Glotzer, Carney, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton, Hickey, Crook, Lian, Hague, Villmann, Willis, GASB: Reese, Patton

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Topics: Elements 3: Asset Definition

Basis for Discussion: FASB Memoranda 30, 30A and 30B

Length of Discussion: 11:52 a.m. to 12:25 p.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier, Trott, and Young; Leisenring (IASB)

Board members absent: Seidman

Staff in charge of topics: AcSB: Hague and Villmann

Staff at Board table: Hague, Villmann, Bossio, T. Johnson, Lott, Bielstein, and Benson

Other participants: By phone: Willis

Summary of Decisions Reached:

The Board continued its discussion of Phase B: Elements and Recognition of the joint IASB/FASB Conceptual Framework project. The Board discussed the following proposed working definition of an asset:

An asset is a present economic resource to which an entity has a present right or other privileged access. An asset of an entity has three essential characteristics:

- a. There is an economic resource.
- b. The entity has rights or other privileged access to the economic resource.
- c. The economic resource and the rights or other privileged access both exist at the financial statement date.

The Board requested that the staff continue developing the proposed working definition by clarifying certain aspects of the definition and amplifying text, particularly the meaning of economic resource and the relationship of rights to contractual promises. It is anticipated that the proposed working definition of a liability will be discussed together with clarifying revisions to the proposed working definition of an asset in September 2006. The IASB discussed similar issues and reached similar conclusions concerning the proposed working definition of an asset at its meeting in July 2006.

Objective of Meeting:

The Board discussed the proposed working definition of an asset within Phase B: Elements and Recognition of the joint IASB/FASB Conceptual Framework project. The objective of the meeting was to obtain consensus from the Board to continue development of the current proposed working definition of an asset, and identify parts of the definition and amplifying text that may require clarification. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

Definition of an Asset

1. Mr. Hague led the discussion concerning the definition of an asset. He asked the Board for approval to move forward with the proposed working definition of an asset and requested any suggestions regarding parts of the

definition and amplifying text that need clarification. He sought approval to continue using the proposed working definition as other aspects of the conceptual framework project are analyzed, particularly the definition of a liability.

2. Mr. Herz asked Board members and staff for comments relating to the proposed definition. Mr. Batavick agreed with the current direction being taken. He noted that the examples of assets developed by staff members demonstrate how the definition presented works. However, he noted that communicating the messages would be difficult and that he believed some of the words used in the definition could be clarified in future drafts. For example, the difference between a *right* and a *promise* are sometimes used interchangeably. A promise is an economic resource in some parts of the amplifying text, but seems to be a right in other areas of the text.

3. Mr. Crooch stated that it is unclear in paragraph 17 of memorandum 30A when an entity would not have an exclusive right yet possess an asset. He challenged the claim that an exclusive right is not necessary for someone to have an asset. He stated that an asset must be exclusive to the person able to claim it as an asset. To exemplify his argument, Mr. Crooch provided an example of owning a 20% share of an oil well, in which the owner has an exclusive right to the 20% undivided interest in the oil well. Mr. Hague agreed that paragraph 17 should be more clearly explained in future drafts.

4. Mr. Trott requested the term *undivided interest* be removed from the amplifying text. He agreed with the general concepts presented in the proposed working definition. He stated that the new information presented in the definition is the idea of a promise constituting an asset. He argued that by itself the term *economic resource* in the definition will not be sufficiently clear and explanatory to constituents and that subsuming the explanation of a promise in the words *economic resource* is not helpful. He suggested the definition be changed to read, "An asset is an existing in-bound promise or other economic resource to which an entity has a present right or other privileged access." Mr. Trott noted that such a definition would help constituents understand that an asset as explained by the term *economic resource* encompasses not only physical, but intangible things. In addition, he suggested using words other than *present right*

in the definition. He argued that to have an economic resource, one must have a right to it. Such a right could be an ownership right or another type of right. He agreed with the staff's analysis of the corn contract example, in which a corn contract gives rise to both in-bound and out-bound promises. He suggested that the term *economic resource* be explained more clearly within the definition and not solely in the amplifying text.

5. Mr. Linsmeier noted that he too is comfortable with the staff's general direction concerning the asset definition. However, he thought more clarity was necessary to explain how the definition would help participants in commercial transactions determine which items are assets. He also noted that there is not enough guidance in the definition concerning the term *economic resource*. He stated that an economic resource is more than an increase in net cash inflows or a reduction in net cash outflows. An economic resource is the "thing" that gives rise to the increase in net cash inflows or reduction of net cash outflows. The "thing" could be physical, contractual, or the ability to restrict access. He argued that the staff must better define an economic resource. Once the term is defined, he will accept that if someone has something present that reduces net cash outflows or increases net cash inflows, it is an asset. An economic resource is the "thing" that allows anyone access to the net inbound cash flows or reduction of net outbound cash flows. The right to that economic resource gives someone exclusive access.

6. Mr. Linsmeier also said that exchangeability is important in the determination of whether an economic resource is currently present—in particular, for some internally generated items, determining that an economic resource is present will be difficult. One indication that an economic resource is present is someone's willingness to buy it. He acknowledged that exchangeability is not a defining criterion, but it is useful in determining whether or not an economic resource is present.

7. Mr. Linsmeier noted that the word *control* is not used in the proposed working definition, but the concept of control still has importance in defining the unit of account. In the corn contract example, one cannot have the right to the corn or payment without the obligation to deliver payment or corn; the right and

obligation are inseparable. He asserted that separating rights and obligations on a balance sheet does not depict the true inseparability of these particular rights and obligations. Thus, even though control does not appear in the definition of an asset, control may be helpful in analyzing unit of account.

8. Mr. Linsmeier argued that the examples in memorandum 30A relate more to the terminology used in the old definition. He stated that the staff must use the new words and characteristics specifically to apply the determination of an asset.

9. Mr. Linsmeier noted that listing property rights as a type of right in the amplifying text is redundant, as property rights are subsumed in the other rights listed—contractual, statutory, restricted, or other.

10. Mr. Herz asked Mr. Linsmeier whether a building is an asset or ownership of a building is an asset. Mr. Linsmeier responded that the economic resource is the building because it can generate future cash flows. It is one's ownership of the building that creates one's right to the building. Mr. Hague agreed with that analysis.

11. Mr. Linsmeier stated that once it is determined that an asset exists, there is a question of whether recognition is subsumed in the definition of an asset or is separate from the definition. There is a possibility that the definition gives rise to recognition. Mr. Hague noted that this will be considered at a later stage of this Phase of the project.

12. Mr. Leisenring stated that some of the former problems identified with using the word *control* also exist when using the word *right* in the definition. However, he said he does not believe *control* should be added in the proposed definition. He noted that control can be defined as "control of an entity" or "control of access." Concerning the latter definition, it has been unclear in the past whether the control stipulation requires one to be able to influence the occurrence of an inbound cash flow to have an asset, or if one has an asset if inbound cash flows happen to occur. He noted that similar ambiguity arises with the term *right*. Referencing the corn contract example, Mr. Leisenring argued that a person's right is simply that the promise is to him and not to someone else. Whether or not the corn is delivered is not something he has control over or to which he has a right in the sense that he may demand it. He asserted that

control and *right* are circular terms, and the staff must better distinguish between an economic resource and a right. He argued that *present right* implies that if someone benefits from something good happening in the future, that person must have had an asset from the beginning. Mr. Leisenring noted that if the corn contract is enforceable at creation, the example indicates that an asset and liability exist at the date of contract creation. He disagreed with the example and stated that a farmer has no rights to payment until he delivers the corn. Mr. Johnson suggested that this would not be the case when the contract requires specific performance—where the delivery of the corn would be required instead of settling the contract on a net basis. Mr. Trott disagreed with Mr. Leisenring on the issue. Mr. Trott stated that if the buyer does not take the corn he promised to accept, the farmer has a right to obtain consideration from the buyer at the agreed upon price. Mr. Leisenring disagreed and asserted that the gross amount of the promise is not faithfully representative of one's right.

13. Mr. Herz stated that such debate on recognition and measurement is beyond the scope of the current discussion. Mr. Hague agreed that Board members are analyzing the examples in the amplifying text in terms of unit of account, which has not yet been brought to the Board for discussion.

14. Mr. Leisenring questioned whether the treatment of the corn contract is the same regardless if the right and obligation to buy and sell corn is at a fixed or variable price. Mr. Linsmeier responded that the fixed price is crucial in the example. He noted that if the corn was at a variable price, it would be a different financial instrument. He added that if someone gives him the right to buy something at a variable rate in the future and the product is scarce, the fact that he has the contract is of value because it gives him the ability to obtain the product in the future. Mr. Trott argued that even at a fixed price, the asset or liability is not the corn, but the contract for the corn. Mr. Linsmeier agreed.

15. Mr. Linsmeier stated his concern that if unit of account is not considered along with the definition of an asset, the balance sheet will contain a list of rights and obligations. In such a case, the analysis of how the rights and obligations link together will be lost. Mr. Leisenring stated that there is too much emphasis on contracts and questioned the ramifications of such a focus on circumstances

without contracts. Mr. Trott responded that such a concern will be mitigated if *promises* are emphasized in the new definition rather than contractual rights and obligations.

16. Mr. Crooch noted that a promise from someone is not an asset if it is a worthless promise. Mr. Leisenring stated that a contractual receivable that is worthless is not an asset. He also noted that if rights and obligations are enforced for trivial amounts of things, one might consider expectations to be assets. Mr. Linsmeier responded by noting the importance of focusing on *present* economic resources to mitigate such a situation. Mr. Bossio stated that the presence, enforceability, and value of the right are important factors to consider. If something becomes valueless and there is no chance of receiving anything, then it may no longer be an asset. Once someone decides that a right exists, it is important to determine who possesses ownership of the right. Mr. Leisenring asked if a spot in any line is an asset, or if that spot in line must be valuable. In addition, he argued that if the spot in line (for example, in the case of the contract for a supply of corn) is worthless, there is no asset. Mr. Leisenring stated that in assessing the value of an item, the resource is being confused with its outcome. Mr. Hague answered by explaining that one must have an economic resource to have an asset. Mr. Bossio added that scarcity of the promised item presumes a value.

17. Mr. Crooch questioned whether one has an asset if he pays cash for a 20% ownership share of an undrilled oil field. Mr. Herz answered affirmatively, stating that there is an asset in that circumstance because there is a non-zero probability of future inbound cash flows.

18. Mr. Herz asked Board members whether they had any additional comments. Mr. Herz noted that the definition of an asset is an essential definition and requested an indication of the staff's plans to proceed. Mr. Hague stated that the definition of an asset will not be issued for comment until other elements are developed and analyzed by the staff. He noted that the staff wants the Board's consent on the general concepts in the proposed definition and amplifying text. Upon Board approval to move forward, the staff will develop the

definition of a liability and address unit of account, which may help in solidifying the definition of an asset.

19. Mr. Leisenring stated that he is not comfortable with *present* appearing twice in the definition. Mr. Johnson noted that some Board members suggested analyzing the definitions of a liability and asset together, which may help in determining the best wording for the definitions. Mr. Herz stated that he hopes to continue moving forward with the project. Mr. Johnson noted that the definitions being developed will be analytical tools used to solve other accounting issues, and thus definitions that are too vague will not be helpful. Mr. Batavick stated that the words *probable* and *control* have been historically problematic in the old definition, and the removal of such words constitutes progress toward a strong definition of an asset. Mr. Hague stated that the staff will present an updated version of the definition of an asset and a definition of a liability at the September Board meeting. Board members approved moving forward.

Follow-up Items: None.

General Announcements: None.