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COMMENTARY

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The Concept of Assets in Accounting Theory

SYNOPSIS: The FASB's definition of assets needs to be revised. It confuses definition with measurement, stocks with flows, and it lacks empirical content. The definition cannot be used in practice to make clear distinctions between assets and expenses. A clearer distinction between assets and expenses would be possible if assets were defined as property-rights. All resources used by an enterprise have bundles of rights attached to them. These rights include the rights to use a resource, to change its form or substance, and to sell or rent it to others. By contractual arrangement, these rights are often distributed among various owners. The partial rights of each owner represent assets of that owner.

If assets were defined as property rights, many of the costs that are deferred and recognized as separate assets under current GAAP would be eliminated. Some costs would be charged to expense when incurred, others would be reclassified as part of the costs of other assets or netted against liabilities. In classifying costs as assets or expenses, the focus would change from estimating future economic benefits (or net cash inflows) to associating costs with rights to use economic resources (or wealth). Eliminating deferred costs that are not rights to use wealth would improve the understandability, relevance and comparability of financial statements.

In the conceptual framework of the FASB, assets are the most fundamental accounting elements. Liabilities are defined, in essence, as negative assets, equities are defined as assets minus liabilities, and comprehensive income and its components (revenues, expenses, gains and losses) are defined as changes in equity, or net assets. All other accounting elements, in other words, are derived from the concept of assets. Thus, defining assets in an unambiguous manner is a fundamental priority in the conceptual framework.

In Concepts Statement No. 6, the FASB (1985) defined assets as *probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events*. This definition is often criticized for being too complex and ambiguous. Walter Scheutze, former Chief Accountant of the Securities and Exchange Commission and former FASB member, had this to say about it:

> The FASB's definition is so complex, so abstract, so open-ended, so all-inclusive, and so vague that we cannot use it to solve problems....The definition does not discriminate and help us to decide whether something or anything is an asset. That definition describes an empty box. A large empty box. A large empty box with sideboards. Almost everything or anything can be fit into it. (Scheutze 1993, 66)

The main use of a definition of assets in accounting practice is to classify costs incurred as either assets or expenses. A clear, unambiguous definition is needed to establish accounting policies involving the asset/expense distinction and to implement established policies in the various circumstances in which costs are incurred. In Scheutze's view, the FASB's definition does not clearly enough

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distinguish assets from expenses and is therefore used to justify the recognition of assets which have little if any relevance to an assessment of the financial position of an enterprise.

A clearer distinction between assets and expenses would be possible if assets were defined as property rights. A theoretical foundation for defining assets as property rights can be found in Irving Fisher's *The Nature of Capital and Income* (1906). In his book Fisher equated assets with property, or property rights. Property rights lie at the heart of economic activity. The modern theory of property rights focuses on how, through complex contractual arrangements, production and trade alter the rights of individuals to the uses of goods and services provided by nature. One economist (Alchian 1967, 2) has gone so far to say that:

> In essence, economics is the study of property rights over scarce resources....The allocation of scarce resources in a society is the assignment of rights to uses of resources...the question of economics, or of how prices should be determined, is the question of how property rights should be defined and exchanged, and on what terms.

In its discussion memorandum for the conceptual framework, the FASB (1976) considered a definition of assets based on property rights but later rejected it in favor of a definition based on probable future economic benefits. Unfortunately, this definition links the concept of assets to the concept of matching costs with revenues—a link which is inconsistent with the asset/liability viewpoint adopted by the FASB in the conceptual framework. By defining assets as probable future economic benefits and associating future economic benefits with future cash inflows, the FASB seemed to imply that assets are expected cash inflows, or costs expected to be recovered from future cash inflows (or revenues). This, in essence, is the matching concept.

The matching concept is associated with a "revenue/expense view" of defining and measuring accounting elements. According to the FASB (1976), the revenue/expense view gives priority to the definition and measurement of revenues and expenses, and makes assets and liabilities dependent on revenues and expenses. By contrast, the "asset/liability view" gives emphasis to the definition and measurement of assets and liabilities and makes revenues and expenses dependent on assets and liabilities. The revenue/expense view, epitomized by Paton and Littleton's 1940 monograph, *An Introduction to Corporate Accounting Standards*, has had a long and influential history in accounting theory. It dominated accounting policy making until the formation of the FASB in 1973. FASB's adoption of the asset/liability view represented a significant shift in "official" thinking.

Why did the FASB shift the focus of accounting policy from matching costs and revenues to measuring assets and liabilities? The views of Robert T. Sprouse, one of the original members of the FASB, and Reed K. Storey, a senior technical advisor to the Board during the development of its conceptual framework, provide some insights into why the FASB shifted the focus of accounting policy.

Sprouse, an advocate of the asset/liability view, was critical of the revenue/expense view because of its subjectivity and its relegation of the balance sheet to "a sheet of balances created as a by-product of the matching process." He states:

> In most cases the matching of costs and revenues is a practical impossibility. In practice, most costs are identified with a period of time in much the same way that even proponents of the matching concept identify revenues with a period of time....The matching concept based as it is on the pre-eminence of the income statement and relying heavily on subjective notions of correctness, applicability, and propriety, is responsible for those unique accounting products that one so frequently finds in today's sheet of balances: deferred charges that are not assets and deferred credits that are not liabilities. (Sprouse 1971, 167)

Storey argued that the revenue/expense view often results in the recognition of assets and liabilities that have no correspondence with things in the real-world. After attacking Paton and Littleton's (1940) argument that assets are costs awaiting assignment to future revenues, Storey goes on to say:

> In my opinion, financial accounting's excursion into fantasyland over the last 40 years—our ignoring of correspondence of items in fi-

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> nancial statements with the things and events they are supposed to represent while we were using opinion and judgment to "match costs and revenues properly" and "avoid distorting period net income"—has been the source of a significant number of our major problems and remains one of the greatest dangers we face. (Storey 1981, 3)

By shifting the focus of policy making to the definition and measurement of assets and liabilities, proponents of the asset/liability view were of the opinion that "deferred charges that are not assets" and "deferred credits that are not liabilities" would be eliminated from corporate balance sheets. Except for a few instances, such as research and development costs and start-up costs of companies in the development stage, this has not happened. The matching concept still influences accounting policy to a considerable degree. In part, this is due to the recognition criteria for revenues and expenses in Concepts Statement No. 5, which are rooted in the matching concept, but it is also due to the FASB's (1985) definition of assets in Concepts Statement No. 6.

A definition of assets that is consistent with the asset/liability view needs to disassociate assets from revenues or expected cash inflows and identify them instead with their non-financial, legal and economic characteristics. Experience has shown that a definition tied to the matching concept is too subjective for establishing and implementing clear and unambiguous accounting policies that distinguish assets from expenses. Thus, the motivation for this research—which is to provide an alternative, more useful definition of assets that can be rationalized in the context of a broad theory of the relationship of accounting to economic theory.

The analysis will proceed by first explaining Fisher's (1906) theory about the nature of capital and income, which provides a theoretical framework for the subsequent analysis. Using Fisher's ideas and some concepts from measurement theory, the FASB's definition of assets is critiqued. The implications for accounting policy of a definition of assets based on property rights are then considered before the potential benefits to financial reporting of adopting the proposed definition are discussed in the conclusion to the paper.

Fisher's Theory

Fisher was primarily concerned with the definition of capital and income and their value counterparts, capital value and income value. While the definition of assets was not a central concern, Fisher (1906, 140) stated among his objectives "to show...the application of economic principles to bookkeeping" and "to find the philosophical basis of accounting."

The building blocks of Fisher's (1906, 3) theory are the concepts of *wealth* and *property*. Wealth is defined as "material objects owned by human beings," including human beings themselves. The term wealth is used in a collective sense to include both stocks of wealth at an instant in time and flows of wealth during a period of time. A stock of wealth at an instant in time is called *capital*. *Services* of wealth are "the uses of wealth" or "the desirable changes effected (or the undesirable changes prevented) by means of that instrument (of wealth)." Services are events, and a flow of services over a period of time is called *income*. Since income flows *from* capital, it might be better understood as *outgo*.

Property is the right to use wealth. A *right*, according to Fisher (1906, 20), "is a term of jurisprudence, and brings economics into contact with the whole subject of legal and custom-sanctioned relations." He defines the right of a person to the uses of an article (or instrument) of wealth as "his liberty, under the sanction of law and society, to enjoy the services of that article." Because services owned are always future services, and since all future events are uncertain, a property right can also be defined as "the right to *the chance* of obtaining some or all of the future services of one or more articles of wealth" (Fisher 1906, 22).

In Fisher's system, wealth and property are co-existent. "Wealth is the concrete thing owned; property is the abstract right of ownership. The two concepts mutually imply each other" (1906, 22). Fisher associates wealth with the welfare of the community in general,

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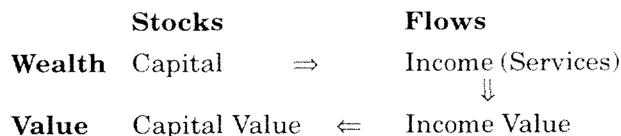
and property with the welfare of the individuals in the community. Excluded from wealth are such things as stocks, bonds and other property rights, which though inseparable from wealth represent property rather than wealth. Because wealth and property are coexistent, the well-offness of the entire community can be determined either by summing up the values of all articles of wealth or by summing up all individuals' property values. And because property rights to articles of wealth can be divided among various individuals, the well-offness of a particular individual in the community can only be measured by the value of that individual's property.

The value of wealth is simply its price times its quantity. Wealth can always be measured in physical quantums such as pounds, gallons or yards. Prices can be observed from exchanges of quantums of wealth. The services of wealth (income) can also be valued, either directly by exchange prices for those services or indirectly by reference to the prices for the underlying capital from which those services flow. The value of capital is found by discounting the value of the expected service-flows of capital. Thus, capital value derives from income, which in turn derives from capital. This relationship can be illustrated by the following diagram:



Assets are equated with property and therefore represent rights to capital and income (the services of wealth). Property is the "flip-side" of wealth and is distinguishable from property value which is its quantity times its price. Assets are abstract rights that can be exchanged. Asset values are monetary representations of property rights.

Accounting Definitions of Assets

In general, definitions of assets have two fundamental components: (1) a component that identifies their economic (or technical) characteristics and (2) a component that identifies their legal (or proprietary) characteristics. In Fisher's (1906) definition, the legal characteristic (property) is prominent, but the economic characteristic (wealth) is also specified. In the FASB's definition of assets economic characteristics (probable future economic benefits) are prominent, but legal characteristics (obtained or controlled by a particular entity as a result of past transactions or events) are also included.

The FASB definition of assets has three fundamental weaknesses, however, that prevent it from being useful in setting accounting policy: (1) the term "economic benefits" can be understood either in a financial sense or a non-financial sense, which confuses the definition of assets with the measurement of assets; (2) the definition lacks empirical content because it confuses stocks and flows by defining assets, which are stocks, in terms of future economic benefits, which are events or flows; and (3) the definition emphasizes the economic rather than the legal characteristics of assets, or the benefits of wealth instead of the rights to use wealth.

Definition vs. Measurement

Consider first the meaning of "economic benefits." FASB (1985, para. 28) relates economic benefits to "service-potential" or "the scarce capacity to provide services or benefits to the entities that use (assets)." According to FASB (1985, para. 30), "assets other than cash benefit an entity by being exchanged for cash or other goods or services, by being used to produce goods or services or otherwise increase the value of other assets, or by being used to settle liabilities." A careful reading suggests that economic benefits represent "the uses of wealth," or "services," using Fisher's (1906) terminology.

It is clear, however, that accountants often interpret economic benefits in a financial sense as cash flows rather than in a non-financial sense as technical services or uses of wealth. Costs are capitalized as assets if the anticipated cash inflows associated with the cost (a cash outflow) are sufficient and probable enough to recover the cost. The expected benefits are the expected cash inflows. Assets are therefore unrecovered costs if measured

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by cost, or anticipated cash flows if measured by net realizable value. Once benefits are interpreted as cash inflows there is little difference between the asset/liability view of accounting and the revenue/expense view, since the definition of assets depends on an association of past cash outflows with future cash inflows.

In a more fundamental sense the interpretation of economic benefits as cash inflows amounts to a confusion of definition and measurement. In the FASB's conceptual framework, the definition of accounting elements is distinguished from the recognition and measurement of accounting elements. Recognition is an accounting concept, but the distinction between definition and measurement is derived from measurement theory.

According to measurement theory, measurement involves the assignment of numerals to objects or events in order to represent certain *attributes*, or *properties*, of those objects and events.[1] Measurement can be defined as a function of two variables, $x = u\ (O,A)$, where u is a transformation of O, the object or event, into a number, x . The function u is a set of measurement rules that quantifies certain attributes, A, of the object (or event). Before measurement can take place, the objects (or events) and their relevant attributes must be defined.

At least two types of definition are possible. *Conceptual definition* relates a concept to one or more other concepts and generally takes the form of dictionary definitions. *Operational definition* relates a concept to what would be observed if certain operations are performed under specified conditions. Operational definitions are preferred by scientists because they provide operations by which the empirical content of an object or attribute is made known. Unless a definition provides an empirical counterpart, it has no scientific significance.

In accounting, the objects and events that are measured are called accounting elements. The attributes measured (historical cost, current cost, net realizable value, etc.) are financial in nature and are based on exchange prices. The definition of accounting elements therefore involves the identification of *non-financial* characteristics that are common to all assets. The term economic benefits, which connotes financial benefits, should be avoided because it leads to a confusion of assets with asset-values, or objects of measurement with attributes of measurement. In the FASB's definition of assets this confusion leads to the recognition of assets that are not rights to uses of wealth.

Stocks vs. Flows

A second weakness of the FASB definition is that it confounds the notion of time by defining assets, which are stocks, as future economic benefits, which are flows. Future events (or flows) can be anticipated but they cannot be observed presently. A definition of assets based on future events lacks empirical content because future events are inherently unobservable.

An alternative might be to define assets as present stocks of future services, or *service-potential*. Services are less likely than benefits to be interpreted in the financial sense as cash inflows. The term services, moreover, is useful in distinguishing assets from expenses: assets are service-potentials; expenses are service-employments, or the using up of service potential. In the final analysis however, service potential is too abstract a term on which to base an operational definition of assets. How does service potential manifest itself in the real world, if not through material wealth? An operational definition of assets ought to connect assets with stocks of wealth (or capital), in the broad sense implied by Fisher.

Another way of defining assets as stocks rather than flows is to define assets as economic resources. In APB Statement No. 4 (AICPA 1970, para. 57), the Accounting Principles Board defined assets as "economic resources of an enterprise that are recognized in conformity with generally accepted accounting principles." De-

[1] The development of measurement theory for the physical sciences is often attributed to Stevens (1946) and Campbell (1957). Churchman (1961) and Ackoff (1962) adapted the ideas of Stevens and Campbell to measurement for the social sciences.

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fining assets as economic resources, however, requires a definition of economic resources.

According to *The Penguin Dictionary of Economics* (Bannock et al. 1984, 378) "resources" are "agents or factors of production used in an economy or firm to produce and distribute goods and services." They are "conventionally classified into Land, Labour and Capital, each of these being a generic name for a possibly large set of productive services." L. M. Fraser (1947, 208–209) identified seven "factors of production" or economic resources: (1) Land, (2) Labor, (3) Capital, (4) Enterprise (or "risk-bearing"), (5) Knowledge (or "technique"), (6) Law and Order, and (7) Consumers. Factors of production, according to Fraser (1947, 198), "represent the *data* or *prerequisites* of the productive process, and...they are to be distinguished both from final products and...intermediate goods; since these categories constitute respectively the results of, and the stages in the production of final goods."

From these definitions it is clear that wealth (as defined by Fisher 1960) and economic resources (as defined by Fraser (1947) and Bannock et al. (1984)) are not the same thing. Tangible economic resources are a special form of wealth used in the production of other forms of wealth. Intangible economic resources such as enterprise and knowledge are not wealth but attributes of wealth—that is, attributes of human beings which are wealth. According to Fisher (1906, 39), "swift horses are wealth, but not their swiftness; honest, wise, successful, and healthy men are wealth, but not their honesty, wisdom, skill or health."

As the term is ordinarily defined, economic resources is too narrow a concept to serve as a basis for defining assets. In APB Statement No. 4 (AICPA 1970, para. 57), however, economic resources were defined very broadly as "the scarce means (limited in supply relative to desired uses) available for carrying on economic activities." According to the APB, they include (1) productive resources (including contractual rights to productive resources), (2) products, (3) money, (4) claims to receive money, and (5) ownership interests in other enterprises. Of these, only productive resources represent economic resources as that term is used generally in economics. And only productive resources, products and money represent wealth, as that term is used by Fisher (1906).

In order to equate assets with economic resources, the APB had to redefine economic resources so broadly that the term bears very little resemblance to its general meaning in economics. Assets are no longer tied to a concept that has a clear meaning. In effect, economic resources are assets recognized under GAAP.

It is clear however that all of the resources (assets) enumerated by the APB can be interpreted as property rights. Productive resources such as raw materials, equipment and plant are assets of the persons who own the rights to use those resources. The same is true for products and money. Claims to receive money and ownership interests in other enterprises are not in themselves resources or tangible wealth, but they are rights to (or claims against) the wealth or resources of others. What distinguishes all of these things as assets is not that they are economic resources, but that they are rights to use wealth.

Legal Characteristics of Assets

Attached to any article of wealth are "bundles of property rights" that can be divided among various individuals by contractual arrangements. The value of an article of wealth exchanged depends directly on the bundle of property rights exchanged (Furubotn and Pejovich 1972, 1139). The greater the bundle of rights transferred, the greater the value of the wealth exchanged. The worth of a house to an individual owner, for example, will be greater if the bundle of rights acquired includes the right to exclude factories and office buildings from the immediate vicinity of the house. In this context, a right of ownership can be understood to mean *the right to use an article of wealth, to change its form and substance, to transfer either all or some of those rights through sale or rental to others, or to share in the profits or losses from its economic employment* (Furubotn and Pejovich 1972, 1140).

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Many of the assets recognized in accounting represent only partial rights to wealth. A partnership agreement divides rights to an enterprise's wealth among several partners. A lease conveys the right to someone to use an article of wealth for a limited period of time, but it may exclude the rights to change its form and substance and to sell it to others. An option conveys a right to purchase or sell an article of wealth but not to use it or change its form and substance. A trust creates a beneficial interest to share in the profits and losses from the economic employment of articles of wealth, but it does not create rights to use, alter or sell them. All of these partial rights have value and should be recognized as assets by their owners.

The problem with the FASB definition of assets, however, is not that it omits property rights from the category of assets, but that it admits things that are not property rights. By emphasizing the benefits of wealth instead of the rights to use wealth, the FASB definition admits as assets deferred costs that are not property rights. These deferred costs are assets only because they were incurred with the intent to benefit future periods and are considered recoverable from future revenues.

The relevance and reliability of financial statements would be enhanced if all assets represented property rights. An enterprise's property rights are needed to carry on its economic activities in the future. Property rights can be exchanged for cash or be used to settle liabilities, and the wealth underlying some property rights can be used to produce other things. Deferred costs that are not property rights lack these characteristics and, therefore, have little (if any) relevance to an assessment of financial position.

If assets were defined as property rights, the focus of the asset/expense distinction in accounting would no longer be the identification of causal links between past costs and future benefits, but the identification of transactions and events that create new rights or enhance existing rights. To capitalize costs, both the right and the material wealth underlying that right would have to be identified.

That all property rights involve underlying wealth may not be clearly evident, especially for receivables and some of the so-called "intangible assets." But, according to Fisher (1906, 33), "it is impossible to have a right to any future wealth which is not also a right to some present wealth as a means of securing that future wealth." A bond, for example, may be viewed as a right to receive principal and interest in the future, but the means to that payment is the concrete wealth of the enterprise. Technically, there should be no distinction between tangible and intangible assets, because property rights are always intangible. But even for the so-called intangible assets such as patents and franchises, there is underlying tangible wealth. Patents and franchises are monopoly privileges granted by government. Their service is the prevention of certain acts of certain persons. In the last analysis, the means to the prevention are the persons who are constrained to refrain, and the wealth withdrawn from competition.

The existence of a right to wealth is often evidenced by a title to wealth or a contract that gives an enterprise limited rights to the uses of wealth. In other cases, a title or contract is absent but a transaction has occurred that gives the enterprise an enforceable claim. A prepayment of wages, for example, gives an enterprise an enforceable claim against a person, even though the enterprise does not own all rights to the underlying wealth (the person) and has not entered into a formal contract with the person. The existence of a right is nevertheless supportable under contract law.

Defining assets as property rights would give empirical content to a definition of assets because property rights rest upon a foundation of contract law. This does not mean that accountants would have to become trained in the law anymore than they already are. Practitioners would follow the guidelines set by accounting policy makers who would interpret the concept of property rights to suit the objectives of financial reporting. Their interpretations need not be limited to legal interpretations of ownership.

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Exchangeability

Some accountants have argued that exchangeability should be a characteristic of assets recognized in financial statements. Scheutze (1993) includes exchangeability in his definition of assets: "Cash, contractual claims to cash or services, and items that can be sold separately for cash." Anything that cannot be exchanged for cash—such as goodwill, capitalized start-up costs or capitalized relocation costs—is not an asset under his definition. This excludes too much from the category of assets, however. Lease rights are significant assets even if the terms of the lease prevent the lessee from exchanging his or her interest in the lease for cash.

The concept of exchangeability might be useful, however, in identifying assets defined as property rights. In general, property rights are exchangeable and the reverse proposition should always be true: anything that is exchangeable is a property right. Exchangeability therefore is a *sufficient* condition for the recognition of an asset. It is not a *necessary* condition however since some property rights cannot be sold. They are nevertheless valuable property rights and should not be excluded from the category of assets. It would be wrong, therefore, to include exchangeability as part of a definition of assets.

Implementing the Proposed Definition

There are many costs that are difficult to classify as assets or expenses because of the inherent weaknesses in the FASB's definition of assets. Typically, these costs represent acquisitions of services that are used up shortly after acquisition and do not create new rights to wealth. Because they are not product costs, their recovery from future revenues is relatively uncertain. If future economic benefits are interpreted as net cash inflows they may however represent assets, depending upon the probability of the future cash flows. It is difficult to write accounting policies that provide clear guidance for these costs because the probability of recovery depends so much on individual circumstances, and assessment of probability for a given set of circumstances depends on personal judgment. Where specific guidance is lacking, some companies capitalize such costs as assets while others charge them to expense when incurred.

In order to give some organization to the following discussion of these costs, they will be divided into the following types: pre-production costs, marketing costs, administrative costs and financing costs.

Pre-production costs relate to production activities, such as research and development, and the acquisition of productive resources that occur before production itself is initiated. Included in this category of costs are research and development costs, product design costs, computer software costs, tooling costs, training costs, relocation costs, plant rearrangement costs, and oil and gas exploration costs. Except for research and development costs, these costs are sometimes capitalized as assets on the grounds that they benefit future accounting periods. In a financial sense, these costs will possibly (or probably) be recovered from future sales of products and may therefore qualify as assets under current GAAP. They are not assets in the sense of rights to future cash inflows, however. To be assets in the sense of property rights they must either create new property rights or enhance the service potential of resources underlying existing property rights.

Training costs improve the service potential of labor, which is an economic resource. Except in slave societies, however, enterprises do not own their employees and human resources are not recognized as assets in accounting. Training costs therefore, do not improve existing assets of an enterprise. They should be charged to expense when incurred. A similar treatment should be accorded prior-service costs incurred when pension plans are adopted or amended. Under current GAAP prior-service costs are sometimes capitalized as assets on the grounds that they are associated with future labor services. Since the enterprise has no enforceable claim to the future services of its employees, however, prior-service costs should not be capitalized.

Some pre-production costs enhance the service potential of existing tangible productive resources such as property, plant and

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equipment. Tooling costs, plant rearrangement costs and relocation costs are examples. Unlike the case of training costs and prior-service costs, there is an argument for capitalizing these costs because they improve existing resources owned by the enterprise. The problem is that when they are capitalized under current GAAP, they are accounted for as assets separately from the assets that they improve. If they do increase service-potential, they should be capitalized as improvements and added to the cost of the property, plant and equipment they improve.

Other pre-production costs involve the acquisition or creation of knowledge. Expenditures for research and development, product design, consulting advice and the development of computer software are examples. The issue here is whether an enterprise *owns* the technical knowledge created by such activities. The knowledge itself should be distinguished from a patent that protects the knowledge. Patents are assets because they prevent others from using knowledge.

In one sense knowledge is an attribute of human beings that cannot be owned by an enterprise. This conforms to Fisher's (1906) notion that intangible attributes of human beings are not wealth. In another sense, however, knowledge is separable from human beings and represents a commodity. It is often stored in physical form and it sometimes can be exchanged for cash or other valuable consideration. To the extent that knowledge is capable of being exchanged, we can assume that an asset exists. Measurement problems may prevent recognition of an asset however. Assets are recognized only when reliable measurement is possible. The financial attribute of productive resources normally measured in accounting is cost or lower recoverable amount. Recoverable amount represents the expected cash inflows from either selling or using an asset in the future. If future cash inflows are very uncertain, reliable measurement may be impossible and no asset should be recognized.

Marketing costs are sometimes capitalized as assets under GAAP if they can be associated with specific future revenues. Pre-release and direct-response advertising costs are examples. Pre-release and direct-response advertising costs are not property rights however. They may increase the likelihood that consumers will buy the company's product but they represent no claim to the future allegiance of customers. They should be charged to expenses of the period in which they are incurred.

Administrative costs that are sometimes capitalized under GAAP include organization costs and start-up costs. Organization costs relate to the formation of a new legal entity, start-up costs to the development of new product lines, production processes and retail outlets. Organization and start-up costs include such things as attorney fees, administrative salaries, travel, advertising and employee training. Collectively, such costs are not property rights because they do not create claims to the services of wealth. Depending upon their individual nature, some of these costs may result in the improvement of existing assets and could be capitalized as part of the cost of those assets.

Financing costs sometimes capitalized include debt issue costs incurred in debt financing and costs incurred by financial institutions in originating loans. Neither of these costs are property rights in themselves and should not be capitalized separately as assets. Loan origination costs, however, are part of the cost of loans granted. They might be capitalized as part of the cost of the outstanding loans, if the financial attribute measured is historical cost. A more relevant financial attribute of outstanding loans, however, may be net realizable value. In that case, loan origination costs should not be capitalized.

Debt issue costs reduce the proceeds from issuing new debt. If the financial attribute of outstanding debt being measured is historical proceeds, debt issue costs represents debt discount that should be amortized over the life of the debt. If the financial attribute measured is discounted-present-value or net-settlement-value, debt service costs should be charged to expense when incurred. In determining the proper accounting treatment of both loan origination costs and debt issue costs, the issue at

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hand is the *measurement* of assets and liabilities, not the *definition* of assets. Costs may be capitalized as part of the measurement of the historical cost of assets or the historical proceeds of liabilities.

The costs cited above were chosen to illustrate the type of analysis that would be made if assets were defined as property rights. The analysis requires a re-orientation of the thinking process used to classify costs as either assets or expenses. The focus changes from relating costs with future revenues (or cash inflows) to associating costs with existing property rights and wealth.

Conclusion

When the FASB shifted the focus of accounting policy making from matching costs and revenues to defining and measuring assets and liabilities, it seemed reasonable to assume that many deferred costs reported as assets in the past would be eliminated from balance sheets in the future. That this has not happened is due in part, at least, to the FASB's definition of assets. That definition is too complex and ambiguous and admits too much to the category of assets. It needs to be revised.

Defining assets as property rights, or rights to the future services of wealth, would improve the relevance, reliability and comparability of financial statements. Many of the deferred costs shown as assets under current GAAP are irrelevant to an assessment of an enterprise's financial position because they cannot be exchanged for cash, be used to settle liabilities, nor be used to produce other things. They are not reliable estimates of recoverable costs because of the uncertainties inherent in their estimation. And because of these inherent uncertainties, some companies capitalize costs as assets that others charge to expense when incurred.

Property rights are relevant to assessment of an enterprise's financial position either because they are exchangeable for other things or because the wealth that underlies them can be used to produce other things. They can be reliably identified because they are connected to material wealth and their existence rests upon a foundation of contract law. If assets were defined as property rights the comparability of financial statements would be improved because it would be easier to write accounting policies that clearly distinguish assets from expenses with the result that there would be greater uniformity in the treatment of similar costs.

Though some accountants who still revere the matching concept might disagree, defining assets as property rights would also improve the relevance and reliability of income statements. Amortization of non-existent assets would be eliminated from the category of expenses, and accountants could abandon the illusion that they are able to match against revenue all of the costs incurred to produce that revenue. The income concept measured by accountants would be a more faithful representation of the changes in net assets of an enterprise during a period of time.

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