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Issue 13
Other intangible fixed assets

Issue 29
Assets boundary for non-produced intangible assets

ASSET BOUNDARY FOR INTANGIBLE NON-PRODUCED ASSETS
OTHER INTANGIBLE FIXED ASSETS

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Asset boundary for intangible non-produced assets – Issue 29

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Executive summary

1. This paper deals with two issues *Asset boundary for intangible non-produced assets* and *Other intangible fixed assets*. The first issue concerns the question, "should instruments involving the securitisation of future receipts of government be recorded as intangible non-produced assets?" It is argued in the paper that they should not and the definitions given in the SNA should make that clear. Furthermore, it is proposed that the category "other intangible non-produced assets" should be eliminated. The second issue concerns what is meant to be included in the asset category "other intangible fixed assets". The description given in the 1993 SNA suggests it is the output of R&D that has not been patented but to which access is restricted to the unit concerned. With the decision to record all expenditure on R&D that is protected as fixed capital formation, this category may appear to be redundant. Nevertheless, the Canberra II Group felt, by a narrow majority, that the category should be maintained just in case some intangible fixed assets could not be allocated to any of the other intangible fixed asset categories.

<u>Recommendations</u>

2. There are three recommendations:

i) The definition of an asset given in the SNA should make clear that the securitisation of future revenue is not an asset in the system. When future income unrelated to any asset recorded on a unit's balance sheet is the subject of securitisation arrangements on the market such arrangements are always to be treated as borrowing. These arrangements involve the transfer of the entitlement to future income, which does not fit the definition of an economic asset.

ii) The category "Other intangible non-produced assets" should be eliminated, and either the category "leases and other transferable contracts" should be redefined to include contracts such as mobile phone licences that are only transferable by means of a change of ownership of the licensee, or another category should be created to accommodate such contracts.

iii) The category "Other intangible fixed assets" should be maintained.

Introduction

3. *Asset boundary for intangible non-produced assets* (issue 29) concerns the question, "should instruments involving the securitisation of future receipts of government be regarded as intangible non-produced assets?", and *Other intangible fixed assets* (issue 13) concerns the question, "what is intended to be included in this category?" We begin by addressing issue 29.

Asset boundary for intangible non-produced assets

Background

4. This issue arose when some European governments raised money by securitising future income receipts. Eurostat's Manual on Deficit and Debt gives the following definition of securitisation (underlined by the author of the present paper): "*Securitisation is where a unit, named the originator, transfers the ownership rights over financial or non-financial assets, <u>or the right to receive specific future flows</u>, to another unit named the securitisation unit, that pays the originator from its own source of financing*." Typically, there is securitisation when the originator receives a payment today from the transfer of ownership rights to a securitisation unit (often a Special Purpose Vehicle) of an asset or <u>of a series of future flows of receipts</u>. The payment is financed by the securitisation unit by the issuance of securities (thus the name "securitisation") that are backed on the assets or on the specific future flows.

5. One example of securitisation has been the transfer of ownership rights by a government of the future receipts of its public lottery. In this case, the securitisation unit issued securities backed on the future earnings of the lottery and paid the government with the proceeds of this issuance.

6. Should such transactions be recorded as the sale of a non-financial asset or as borrowing by government? Eurostat has developed a set of rules for deciding such matters, but it was not helped in doing so by the definitions given by the 1993 SNA regarding intangible non-produced assets: they are not clear cut and are open to different interpretations. Before proceeding further it is pertinent to review the current situation with intangible non-produced assets and the recent decisions concerning them made by the AEG.

7. The intangible non-produced asset category currently comprises the following:

- Patented entities
- Leases and other transferable contracts
- Purchased goodwill
- Other intangible non-produced assets

Patented entities

8. With the agreement of the AEG to record expenditures on R&D as GFCF, patented entities will no longer be recognised as non-produced assets in the system and they will be subsumed into R&D produced assets.

Leases and other transferable contracts

9. The SNA says that an asset in this category exists if the lessee has the right to convey the lease to a third party independently of the lessor. Canberra II Group recommendations regarding this category are the subject of separate issue papers: Contracts, leases and licences and Government permits.

Purchased goodwill

10. This is a catchall of assets not recognised by the SNA elsewhere that account for the difference between the sale price of an enterprise as a going concern and the sum of its assets less liabilities. The unrecognised assets are thought to include brand names, logos, domain names,

franchise rights, etc. The AEG has agreed to all the Canberra II Group recommendations on this issue, which are reproduced below.

(i) An asset class "Purchased goodwill and marketing assets" should replace the existing "Purchased goodwill". Marketing assets is the name given to brand names, logos, domain names, franchise rights and the like.

(ii) The economic nature of purchased goodwill and marketing assets should be clarified along the lines presented in this paper[1].

(iii) Valuation principles for purchased goodwill should be applied consistently, irrespective of whether the entity is a listed or unlisted corporation, a quasi corporation or unincorporated. They should be calculated as the excess of the purchase (or takeover) value of a business over the value of the other assets and liabilities otherwise identified in the SNA system for that business.

(iv) Internally generated goodwill should continue to be excluded, except where its value is evidenced by a sale. In the case of internally generated goodwill, this occurs only with the sale of a business. In the case of marketing assets it can also occur with their independent sale.

(v) The assets should continue to be classified as non-produced assets, even though their value is often driven by productive activity. However, further consideration will be given by the Canberra II Group to whether a term can be found that better reflects the nature of these assets. This will be addressed in the issues paper concerning Classification and terminology of assets (issue 27)[2].

(vi) The assets should not be amortised at a predetermined rate but made subject to an impairment test consistent with the international accounting standards for these assets

Other intangible assets

11. This category is used for assets not elsewhere categorised. Several EU countries currently record mobile phone licences in it. If the category is eliminated these and similar licences would need to be allocated to another category.

<u>Securitisation and anticipated income</u>

12. In most cases of securitisation of future income flows, it is not the rights to the income that are used as collateral, but the obligation of the government to use a sufficient amount of the future income to repay the borrowing in full. If more income is earned than is needed to repay the borrowing, the excess is retained by the government. Because receipts of future income are uncertain, usually "rights" to considerably more income than is necessary to repay the borrowing is used as collateral.

13. If the rights to future government revenue could be an asset, then all future government income—in other words, the power to tax—would be an asset. It is agreed that the power to tax is not an economic asset for the purpose of the SNA.

[1] Issues paper on Purchased Goodwill and Marketing Assets in the SNA.
[2] One suggestion is that it be renamed "other non-financial assets" and be at the same classification level as "produced assets" and "natural assets".

14. Non-financial assets have value because they are expected to provide benefits for their owner. Financial assets have value because a counterparty has a commensurate obligation. A source of future revenue from tax, a lottery, etc. does not fall into either of these categories.

15. It should be noted also that observing that the government is likely to collect a certain type of income in the future has no effect on the country's productive capacity. As such, the anticipated income cannot be a non-financial asset.

16. It seems clear that the securitisation of a future income stream is neither a financial nor a non-financial asset, but a means of securing a loan. Furthermore, this should apply to all institutional units, not just government ones.

17. There is a need to make it clear in the SNA that anticipated future revenue is not an asset. What to do? First, it should be made clear in the definition of an asset that the securitisation of anticipated revenue is excluded. Second, the category "other intangible assets" should be eliminated. As long as this category exists there is the potential for inventive accountants to attempt to use it to create phoney assets. Presumably, mobile phone licences have been put in this category because they were not strictly transferable, and so could not be put in "leases and other transferable contracts". The solution is to either create a separate category for mobile phone licences or change the definition of "leases and other transferable contracts" to allow the inclusion of contracts such as some mobile phone licences that are only transferable by means of change of ownership of the licensee.

18. In page 310, intangible non-produced assets are defined as: "… *constructs of society. They are evidenced by legal or accounting actions, such as the granting of a patent or the conveyance of some economic benefit to a third party. Some entitle their owners to engage in certain specific activities and to exclude other institutional units from doing so except with the permission of the owner. Intangible non produced assets consist of patented entities, leases and other transferable contracts, purchased goodwill and other intangible non-produced assets*."

19. In page 295 (paragraph 13.62) the SNA explains: "*Intangible non produced assets entitle their owners to engage in certain specific activities or to produce certain specific goods or service and to exclude other institutional units from doing so except with the permission of the owner. The owners of the assets may be able to earn monopoly profits by restricting the use of the assets to themselves. Included are patented entities, leases and other transferable contracts, and purchased goodwill*."

20. The first definition (page 310) is quite general. First, the term "*construct of society*" is quite vague and leaves open a number of possibilities. Second, the existence of "an *accounting action, such as the conveyance of some economic benefit to a third party*" is also a quite general criterion. The following examples in the paragraph are not exhaustive and appear to leave the door open for such things as the securitisation of anticipated government revenue.

21. The second definition (page 295) is more specific and makes it clear that the ownership of the asset entitles the owner to engage in a productive activity from which it earns income. This clearly excludes the securitisation of revenue, in which the purchaser of the asset does not engage in any productive activity at all.

Recommendations

22. The following changes should be made to the SNA:

i) The definition of an asset given in the SNA should make clear that the securitisation of future revenue is not an asset in the system. When future income unrelated to any asset recorded on a unit's balance sheet is the subject of securitisation arrangements on the market such arrangements are always to be treated as borrowing. These arrangements involve the transfer of the entitlement to future income, which does not fit the definition of an economic asset.

ii) The category "other intangible non-produced assets" should be eliminated, and either the category "leases and other transferable contracts" should be redefined to include contracts such as mobile phone licences that are only transferable by means of a change of ownership of the licensee, or another category should be created to accommodate such contracts.

Other intangible fixed assets

23. Other intangible fixed assets are defined as (page 308) *"New information, specialized knowledge, etc., not elsewhere classified, whose use in production is restricted to the units that have established ownership rights over them or to other units licensed by the latter.* This would seem to comprise the outputs of research and development (R&D) not included in patented entities (and which are classified as intangible non-produced assets), but to which access is restricted to the unit concerned. With the decision by the AEG to record all expenditure on R&D that is protected as fixed capital formation it would appear that the other intangible fixed assets category is redundant. Nevertheless, the Canberra II Group felt, by a narrow majority, that the category should be maintained just in case some intangible fixed assets could not be allocated to any of the other intangible fixed asset categories.

Recommendation

24. The category "Other intangible fixed assets" should be maintained.