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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IASB Meeting:	**March 2009, London**
Project:	**Conceptual Framework: Measurement (Phase C)**
Subject:	**Choosing between a Current Measure and a Non-Current Measure (Agenda paper 2)**

INTRODUCTION AND DEFINITIONS OF TERMS

1. At November meetings with IASB and IASB, the Staff suggested the following five factors for distinguishing between items to be reported at current amounts and items to be reported at a past transaction price or other non-current amount:

   a. Value-flow weighting and separation
   b. Confidence level
   c. The measurement of similar items
   d. The measurement of items that generate cash flows together
   e. Cost-benefit.

2. Value-flow weighting (the first part of factor (a)) attracted the most attention from Board members, and the Staff is now convinced that it is the primary factor to consider in choosing between a current amount and a non-current amount. Consequently, the Staff has renamed *value/flow weighting* as *value realization* and is using it to divide the population of assets and liabilities into two very different subpopulations:

   i. Those whose value is realized directly

ii. Those whose value is realized indirectly.

The Staff has made *separability of value flows from value changes* a separate factor that will be discussed with the remaining four factors of the original five that were discussed in November.

3. In the past the Staff has made a distinction between amounts that are measurements in a strict sense and those that are not measurements. The Staff called the latter *quantifications.* Some Board members found that term unclear or unhelpful. Since then, the Staff has searched for a term that could encompass both quantifications and measurements but that would not imply that all of those things are measurements. In this paper, the noun *measures* is used. In English, at least, the definition of *measure* is broad, and can include measurements, estimates, values, and calculations. If the term *measure* cannot be made to work the same way in other languages, the Staff may have to revert to using the term *measurement basis* and simply note that not all measurement bases are measurements.

4. The remainder of the paper is organized as follows. The Staff first explains what direct and indirect value realization mean and describes the subpopulations of direct and indirect realization items. Second, the Staff discusses the effect of the form of value realization on the choice between a current measure and a non-current measure. The importance of each of the remaining five factors for the subpopulations of direct and indirect realization items is discussed next. The paper ends with questions for the Boards and an indication of the plans for future board meetings.

DIRECT AND INDIRECT VALUE REALIZATION

5. *Value realization* refers to the conversion of the economic value of an asset or liability into cash, other assets, services, or release from obligations. Value realization for assets may be direct or indirect.

6. *Direct value realization* means realization in one step. Direct realization assets convert directly to value flows by being exchanged for economically valuable items or by receipt of economically valuable items (collection) according to the terms of a contact. As far as we are aware, value realization for liabilities is always direct. That is, liabilities convert in one step to outflows of value in the form of assets, newly issued liability or equity instruments, or the provision of services.

7. *Indirect value realization* means realization in more than one step. The conversion of raw materials into manufactured inventory that is sold, the use of machinery and equipment to produce inventory that is sold, and the use of land, buildings, vehicles, furnishings, and equipment to support production, selling, and administrative support activities are all examples of indirect value realization. The use of assets in providing services also falls into the category of indirect value realization.

8. Values of indirect realization assets are often realized in conjunction with the use of other indirect realization assets. In contrast, when an asset is sold or exchanged, its value is realized separately, even if that asset is sold or exchanged as part of a group of assets.

9. Asset value realization is neither an either-or nor an all-or-nothing proposition. Holders of most (if not all) types of assets may choose to realize their values directly or indirectly. For example, productive assets may be used temporarily and then sold.

VALUE REALIZATION AND THE CHOICE BETWEEN A CURRENT AND A NON-CURRENT MEASURE

Relevance and Value Realization

10. The Staff believes that current measures of items in financial statements are always relevant to users, but the degree of relevance varies depending on the nature of the item being measured. In general, we think that current measures are more relevant to users when value is realized directly and less so when value is realized indirectly. Liabilities and directly realized assets are direct claims to economic value flows. The current values of liabilities and directly realized assets are determined by those flows of economic value. Therefore, the current values of those items relate directly to the amount, timing, and uncertainty of the future value flows that will result from them.

11. On the other hand, the value of indirect realization assets is usually jointly realized. That is, indirectly realized assets may produce value flows only if used in conjunction with other assets. There are two reasons why current value may be less relevant and more costly for those assets. First, identifying value flows attributable to a particular asset that is used to produce value with other assets is difficult, if not impossible. Second, price or value changes of indirectly realized assets do not necessarily lead directly to changes in future value flows. The joint effect of other recognized assets used to produce goods or services, as well as the presence of unrecognized intangible assets and other factors such as technical

capabilities, supply chains, distribution channels, and management expertise may affect future value flows as much or more than changes in values of individual assets.

12. Furthermore, the results of using assets as a group (which often includes unrecognized intangibles) are evidenced in both the statement of comprehensive income and the statement of cash flows. That historical flow information seems likely to be more relevant for assessing the prospects for future value flows from indirect realization assets than current value information. Using current measures for indirectly realized assets and recognizing changes in those values in income would usually entail more costs to preparers than benefits to users.[1] Thus, non-current measures would generally seem to be the best choice for indirectly realized assets

Possible Future Refinements

13. Although the Staff generally thinks that current measures are most important for directly realized assets and liabilities and that non-current measures are at least as useful for indirectly realized assets, there are exceptions.

14. For some assets whose value is realized indirectly, a current measure may be as useful to users as a non-current measure. The Staff has identified three categories of indirect realization assets where that might be the case, namely:

i. Those assigned a measure at a group unit of account level (for example, a cash-generating unit) such that the group asset has the characteristics of a direct realization asset even though the individual assets included in the group are clearly indirect realization assets

ii. Those for which sale or exchange is an economically significant and viable alternative to use in the production of goods or provision of services (for example, an office building)

iii. Those whose value in exchange is directly correlated to the value produced by the entity even though they are not direct realization assets (for example, the major assets of some entities used to provide air, land, and water transportation services).

[1] See paragraphs 24, 25, and 32.

15. The Staff plans to return to the Boards in April with a paper that discusses those exceptions in the context of a decision tree that makes the first cut in the choice between a current and a non-current measure using the value realization factor.

EFFECT OF OTHER FACTORS ON THE CURRENT MEASURE/NON-CURRENT MEASURE CHOICE

16. The Staff thinks that a consideration of relevance through the factor of value realization is the primary step in making a choice between a current measure and a non-current measure. However, a consideration of the other factors may either influence that choice or the choice of a particular measure within the larger categories of current and non-current measures.

17. Because the other factors appear to have a different bearing on direct and indirect realization items, those factors are discussed separately for the two subpopulations.

Liabilities and Direct Realization Assets

Separability of Value Flows and Value Changes

18. Assessment of prospects for future value flows for items that directly produce economic value flows is value based. In other words, it is the current value that is most important for assessing future flows related to the existing assets and liabilities. Consequently, separating (in the performance statement) changes in current values from flows of economic value may not be useful for most items that directly produce economic value flows.

19. However, the ability to separate value flows from value changes may provide useful information for entities whose primary activities include originating financial assets or liabilities by direct interaction with customers (as opposed to transacting on exchanges or in secondary markets). For those entities, analysis of past value flows may provide insights into the their ability to generate future assets and liabilities (that is, to reinvest proceeds realized from current assets or to fund outflows related to current liabilities), which obviously is an important component of analysis. Entities in that category include financial institutions such as banks, leasing entities, and insurance companies.

Confidence Level (Similar to Statistical Reliability or Precision)

20. The relevance of a current measure is much greater for items to be realized directly than for items to be realized indirectly. At the same time, the confidence level of some current measures, such as price estimates, is lower than that for other measures that are calculations. Because relevance is the first consideration in choosing a measure, we think that a lower level of confidence (or higher level of uncertainty) should be tolerated if the measure chosen for a direct realization item is a measurement or estimate rather than a calculation.

21. That does not mean that confidence level would have no effect on decisions about the measurement of items realized directly. It might have an effect on a decision to assign a measure to an item that will directly produce value flows far into the future based on factors that cannot be known now and for which there are no market transactions from which to infer market participant information. However, in such a case, a non-current measure would provide essentially no useful information. Therefore, a decision not to use a current value estimate might force users to rely on disclosure of qualitative information.

Assigning Measures to Similar Items[2]

22. Failure to assign similar measures to similar items is one of the biggest problems (the other being derecognition) in standards relating to financial instruments. Eliminating or at least simplifying the so-called "mixed attribute model" for financial instruments and similar direct realization items will continue to be a goal of the Boards. This factor acknowledges this goal and is consistent with it.

Assigning Measures to Items that Generate Value Flows Together[3]

23. Items that generate cash flows directly normally generate them individually (although pricing may differ for diversified portfolios than for individual items). Therefore, this factor is not likely to have much effect on measurement decisions for the class of items that generate cash flows directly.

[2] Changed from "***Measurement*** *of similar items"* to reflect our use of the term ***measure*** in this paper.
[3] A similar change from **measurement** to **measure** has been made here.

Comparison of Costs to Benefits

24. The cost of estimating current measures is an important issue for preparers of financial statements. The benefit to financial statement users of receiving current value information is also significant. In other words, the cost of not receiving current value information for items that generate value flows directly is an important issue for users of financial statements.

25. Balancing issuer costs against user benefits (or costs) is always a judgment call for the Boards, but for items that generate value flows directly, the benefits of current value information should have much greater weight than the benefits of current value for items that generate value flows indirectly.

Indirect Realization Assets

Separability of Value Flows and Value Changes

26. Analysis of past value flows is a primary input for assessing prospects for future value flows related to items that indirectly generate flows. Consequently, the ability to separate value changes from value flows is very important for items that indirectly generate value flows.

Confidence Level

27. Based on the discussion of relevance and value realization, the level of confidence in a measure should be less of an issue for indirect realization assets because, in most cases, a non-current measure may be expected to be used. Non-current measures are typically either past transaction prices or calculations, both of which have a high confidence level.

28. However, if a current measure is considered for an indirect realization asset, the confidence level of that measure (which may be lower than that of a non-current measure) may become important because it may make a difference in which current measure is selected or in whether a current measure is selected at all. Thus, the confidence level of a current measure is more likely to make a difference in a decision involving an indirect realization asset than in a decision about assigning a measure to a direction realization asset or liability.

Assigning Measures to Similar Items

29. This factor was identified as being very important for items that directly generate cash flows. It is less important for assets that indirectly generate cash flows, primarily because assigning the same measure to assets that generate value flows together is a much more important issue.

Assigning Measures to Items that Generate Value Flows Together

30. Items that indirectly generate value flows often generate them only when used together. Therefore, this factor is likely to have a significant effect on the choice of measures for the class of items that indirectly generates cash flows.

31. Current standards acknowledge the difficulty of identifying value flows associated with individual items. It also is unlikely that users can do the reverse—associate changes in current prices or values of assets with the value flows likely to be generated in the future. Consequently, picking and choosing assets to be measured at current prices or values because the information is readily available would seem not be very useful to users. Not only would they have difficulty associating those random value changes with future value flows, but also confusion can result because for some assets, value changes flow through income and for others depreciation or similar charges flow through.

Comparison of Costs to Benefits

32. Cost of estimating current values is an issue for issuers of financial statements. Benefits to financial statement users of receiving current value information are less significant for items that indirectly produce value flows. In other words, the cost of not receiving current value information for items that indirectly generate value flows is not as much of an issue for users of financial statements.

QUESTIONS FOR BOARD MEMBERS

33. ***Do you generally agree with the staff's approach to choosing between current and non-current measures?***

34. ***If so, can you suggest improvements to the approach?***

35. ***If not, what alternative would you suggest?***

NEXT STEPS

36. With the next paper, the Staff plans to return to the Boards to discuss the application of this paper's ideas to more specific guidance for choosing between a current measure and a non-current measure. The Staff is also planning a paper that discusses general guidance for selecting a specific measure for asset or liability presentation once a choice has been made between a current measure and a non-current measure.