March 2014

Conceptual Framework: An Approach to Presentation and Measurement

Thomas J. Linsmeier

FASB Member

FINANCIAL ACCOUNTING STANDARDS BOARD

Disclaimer

The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations. My colleagues on the Board have not provided any input to this paper and may disavow themselves from these views.

An Integrated Approach to Presentation and Measurement

A. Separate presentation of items in the statement(s) of financial performance with different implications for analysis
   1. Operating vs. non-operating items
   2. One-time vs. recurring items

B. Historical cost (HC) vs. fair value(FV) measurement based on
   1. Incentives (disincentives) for realization before maturity and
   2. Abilities (opportunities) for realization before maturity

Categories of Comprehensive Income

1. Operating
   - Transactions with customers, suppliers and employees
   - Income, expenses, gains and losses related to assets and liabilities used in or arising from production, marketing and distribution of the entity’s goods or services
   - Includes liabilities with operating and financing characteristics (e.g., normal service cost pension liability, demand deposits)
2. Non-operating
   - Transactions with other than customers, suppliers and employees
   - Income, expenses, gains and losses related to assets and liabilities that are not considered operating

Advantages

1. Easier to identify operating/non-operating if described this way
2. Potential demand for OCI and recycling is diminished (if not eliminated)
   - Non-operating activities generally never become operating
     - Are there any exceptions (e.g., cash flow hedges, foreign currency translation gains/losses)?
     - If so, would this provide an opportunity to develop a consistent conceptual basis for OCI and/or recycling?

Measurement Categories

- Original transaction price (TP)/recognition amount is allocated without remeasurement to income of different periods
- Original TP/recognition amount is remeasured downwards (or perhaps even upwards) for changes in cash flows without remeasuring the discount rate, if any
- Original TP/recognition amount is remeasured for all changes in cash flows and discount rates, that is it is remeasured to FV or another current value

Note: the first two categories comprise the measurement basis that is commonly described as HC

Selection Between HC and FV Measurement

- Based on the objective of financial reporting, resource providers in determining the cash flows they expect from their investments desire information on
  - Amount, timing and uncertainty of net cash inflows to the entity
  - How efficient and effective management has discharged its responsibility to use the entity's resources
- Leads to focus on
  - Statement(s) of financial performance
  - Potential relevance of recognizing unrealized gains and losses (UGLs) in comprehensive income

Factors in Selection Between HC and FV Measurement

- UGLs are decision-useful in meeting the objective of financial reporting if there is a potential that an asset or liability will be sold or settled before maturity or the end of its useful life
  - In this case, both changes in cash flows and discount rates have the potential to be realized
  - Otherwise if no potential to transfer the asset or liability, UGLs will be remeasured to zero at maturity or the end of useful life

Factors in Selection Between HC and FV Measurement

- An asset or liability may be sold or settled before maturity or the end of its useful life when there is
  - No disincentive to sell the asset or settle the liability
    - Is that asset or liability being used internally (e.g., synergistically with other assets) in a manner that makes it economically unwise to sell or settle before maturity or the end of its useful life?
  - No impediments preventing sale or settlement
    - Is there a legal restriction preventing sale/settlement?
    - Is the asset or liability readily exchangeable (e.g., is there a market on which it can be exchanged)?

Outcomes of Applying Factors for Selecting Between HC and FV Measurement

- Financial assets would tend to be remeasured to FV because there is an opportunity to sell (a market often exists) and no disincentive to sell (these assets often are not used synergistically with other assets)
- Assets necessary for operations (including intangibles used in operations) would tend not to be remeasured to FV because they are used synergistically with other assets and therefore there is a disincentive from selling
- Few liabilities other than derivative liabilities would be remeasured to FV because there often is a legal restriction on transfer and therefore there is no opportunity

Factors in Selecting Between Two Types of HC Measures

- Allocate original transaction price (TP)/ recognition amount without remeasurement to income of different periods when
  - Expected cash flows do not differ materially from expectations at recognition
- Remeasure original TP/recognition amount downwards (or perhaps even upwards) for changes in cash flows without remeasuring the discount rate, if any, when
  - Expected cash flows differ materially from expectations at recognition and
  - The conditions for FV measurment are not met
- For this latter remeasurement, the decision to remeasure downward not upwards could be based on prudence
  - Remeasure assets downwards only; remeasure liabilities upwards & downwards

Measurement Chapter of the Conceptual Framework

Based on this analysis the measurement chapter of the conceptual framework should provide a basis for determining

- When to use the following subsequent measurement methods (a) allocated HC, (b) HC with remeasurements of cash flows and not the discount rate, if any, and (3) fair value or another current value measure
- When we should discount and at what amount
- Whether, and, if so, when and how, measurement uncertainty should have an effect on subsequent measurement

Objective of this Session

- To obtain your reactions about the paper and presentation
- To determine your views about which, if any, of these items are important for consideration in the development of conceptual framework chapters on
  - Presentation and/or
  - Measurement