Estimates of the Future in Today’s Financial Statements

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How, not if

- Not new
- Virtually all financial statement amounts include estimates
- Based on events that have occurred by the time the estimate is made
- Asset and liability definitions refer to future inflows and outflows of benefits
- Question is how to do it

Which measurement attribute?

- Choice of measurement attribute affects how estimates are included
- Presently, use multiple attributes
- Conceptually unappealing, confusing to users
- Similar transactions and events treated differently

Why fair value?

- Comprehensive and internally consistent
- *Framework*'s qualitative characteristics
  - Relevance, comparability, consistency, timeliness
- Focus is on measuring assets and liabilities, following the *Framework*

Which asset or liability?

*An **asset** is a resource controlled by the entity as a result of past transactions and events and from which future economic benefits are expected to flow to the entity.*

*A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.*

Which asset or liability?

- Not all expected inflows and outflows are assets and liabilities
- Consider banks' deposit liabilities
  - Deposit liability *and* customer relationship intangible?
  - What is the past event?
  - Does the bank control the expected inflows?

Expected future transactions?

1. Conclude that expected transactions are the result of past events and are under the entity's control
2. Develop new asset and liability definitions
3. Leave them unrecognised, but clarify past transactions and control

Effects on income: Measurement

- Asset and liability measures determine income measure
- Including expectations today means not including them tomorrow
- Interpretation of income depends on measurement attribute
- Unit of account determines what synergies are recognised

Effects on income: Predictability

- Income will be less predictable
- Problem? Not necessarily
- Key is ability to predict future cash flows, not accounting income
- Artificial predictability reduces relevance
- Income reflects changes in economics during the period

Effects on income: Disclosure?

- Disclosure is not a substitute for recognition
- Can be complement
  - Alternative asset and liability measures
  - Inputs to estimation process
  - Risk assessments
- Second moment information is generally lacking and could be useful

Summary

- Including estimates of the future is not new, but it is increasing
- How depends on measurement attribute, asset and liability definitions
- How affects interpretation of income
- Unlikely to recognise all estimates
- Hope is to provide more relevant information to users

Thank you