Conceptual Framework

Measurement 2B: Historical Measurement Bases

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PURPOSE OF MEMO

1. The purpose of this memo is to (1) label and define all measurement bases associated with historical cost, (2) provide clear examples of each basis, and (3) classify these bases according to their relationship to price or value, as well as their time frame orientation.

2. To craft the labels, definitions, and examples for this memo, the staff considered a number of sources, including the conceptual frameworks of standard setters in Australia, Canada, New Zealand, the United Kingdom, and the United States. The staff also considered the FASB discussion memorandum, Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement (FASB 1976) and the IASB discussion paper, Measurement Bases for Financial Accounting – Measurement on Initial Recognition (IASB 2005). Finally, the staff considered a few studies and academic reports related to measurement bases.

HISTORICAL MEASUREMENT BASES

3. Although frequently used, the historical cost label itself rarely indicates the particular costs to which it refers. For example, does the historical cost of a printing press reflect simply the price paid for the press with no other transaction costs included? Does it include any sales or use tax paid, or investment tax credits, rebates, or other incentives received? Does it include...
the price to ship, install, and otherwise make the press ready for printing? If the press was purchased as part of an existing facility, does the historical cost reflect the estimated price to purchase the press separately or a proportionate allocation of the price paid to acquire the whole facility?

4. The existing definitions of historical cost in the FASB’s and IASB’s conceptual frameworks and in the IASB’s discussion paper on measurement bases (IASB 2005) do not distinguish between these costs. For assets, historical cost is defined as:

   The amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations (SFAC No. 5, par. 67(a)).

   The amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition (IASB Framework, par. 100(a)).

   The fair value of the consideration given to acquire an asset at the time of its acquisition (IASB DP, par. 77).

5. For liabilities, the parallel term to historical costs is historical proceeds, which is defined as,

   The amount of cash, or its equivalent, received when the obligation was incurred, and may be adjusted after acquisition for amortization or other allocations (SFAC No. 5, par. 67(a)).

   The amount of proceeds received in exchange for the obligation… (IASB Framework, par. 100(a)).

   The fair value of the consideration received in exchange for incurring the obligation at the time it was incurred (IASB DP, par. 77).

6. As is the case with the term historical cost, the term historical proceeds is somewhat vague. It is not clear whether the historical proceeds of a liability is a gross notion (representing the base amount of liability incurred or face amount of debt issued, for example), or whether it is a net notion (representing a base or face amount less transaction fees or other amounts paid when obtaining a loan or issuing a debt instrument, for example).
7. None of the definitions of historical cost or historical proceeds clarifies which of the many costs mentioned above are actually included in the historical cost of an asset or the historical proceeds of a liability.¹ In fact, the definitions seem broad enough to capture all costs associated with the acquisition of an asset or liability as well as adjustments for depreciation and amortization. At the same time, the definitions can be construed more narrowly to capture only the price of an acquired asset or the proceeds from an incurred liability, while ignoring transaction costs, costs to prepare for use (in the case of an asset) or issuance costs (in the case of a liability). As a result, the term historical cost on its own is quite indeterminate and potentially confusing in any discussion of the merits of various measurement bases.

8. This section labels, defines, and provides examples of measurement bases associated with historical costs. It also classifies each of these bases in terms of: (1) the time frame to which the measurement basis refers, and (2) the relationship of the basis to the economic notions of price or value. This common vocabulary of historical measurement bases is intended to facilitate more productive dialogue and evaluation of measurement bases during milestone II of the measurement phase.

**Past Entry Price**

9. The first basis is *past entry price*. For assets, this basis is defined as:

   The net amount of cash or cash equivalents paid or the cash equivalent amount of other consideration given in exchange for an asset, ignoring any amounts paid for transaction-related goods or services.

For liabilities, this basis (*past entry proceeds*) is defined as:

   The net amount of cash or cash equivalents received or the cash equivalent amount of other consideration received in exchange for incurring a liability, before deducting any fees or amounts paid for transaction-related goods or services.

¹ SFAS No. 34, *Capitalization of Interest Costs* (FASB 1979) provides a more explicit definition of historic cost, indicating that it includes “the costs necessarily incurred to bring it to the condition and location necessary for its intended use” (par. 6). This definition is consistent with the staff’s notion of past gross entry price, described later in this memo.
10. Past entry price, sometimes referred to as historical exchange price, is the most basic of all historical measurement bases. Its distinguishing characteristic is that it includes only the transacted price of the acquired asset or liability while ignoring all other prices for goods and services associated with the acquisition, including shipping charges, sales tax, commissions, document preparation fees, legal fees, and prices paid to install or otherwise make ready for use. The label “past entry price” is used to signal that this basis is nothing more than an “entry price” (as described in Measurement Paper 2A, paragraph 14) that was transacted in the past to acquire an asset presently owned by an entity.

11. As suggested by its label, past entry price refers to a past time frame. The actual inputs for this measurement basis are often taken from transaction documents or electronic records such as invoices. As also suggested by its label, past entry price is a price, not a value. It represents a monetary amount at which two market participants exchanged an asset or liability in a past transaction, or the cash equivalent amount of non-cash consideration actually given or received in exchange for the asset or liability.

12. There are a number of situations in which a past entry price is reported in financial statements today. For example, when a retailer not subject to sales and use taxes purchases inventory directly from a local wholesaler who doesn’t charge for local deliveries or allow discounts on early payments, the inventory is reported on the balance sheet at its past entry price.² Because there are no other prices for goods or services directly related to the acquisition of the inventory (for example, shipping, handling, and forgone discounts) or preparation for its use, the inventory is reported simply at its past entry price.

13. As another example of this basis, consider accounts payable for the retailer in the prior example. If, instead of paying cash for the inventory, the retailer purchased the inventory on account, the retailer’s accounts payable would be reported simply at the past entry price of the purchased inventory (assuming no prepayment discounts exist).

² If the purchase terms allowed a discount for early payments, then the past entry price for the inventory would be the discounted amount owed. If the undiscounted amount were recorded for the inventory, that amount would include not only the past entry price of the inventory, but also the cost of essentially borrowing from the wholesaler during the undiscounted period of the account payable (see IAS 2, par. 18).
14. Finally, prepaid insurance is also reported at past entry price on the balance sheet. There are typically no transaction-related goods or services provided with insurance, nor are there prices to install or otherwise prepare the insurance for use. So, the amount at which prepaid insurance would be recorded equals the past entry price itself.

15. None of these examples represents a situation in which an accounting standard requires that only the past entry price be recorded while amounts paid for all other transaction-related goods or services be immediately expensed. Instead, these examples simply do not have any transaction-related goods or services associated with them. As a result, a past entry price is all that can be recorded for the asset or liability. The staff makes this point to clarify that no current accounting standard prescribes past entry price as a measurement basis.

**Past Gross Entry Price**

16. The next basis is *past gross entry price*. For assets, this basis is defined as:

   The net amount of cash or cash equivalents paid or the cash equivalent amount of other consideration given in exchange for an asset, including those amounts paid for transaction-related goods or services.

For liabilities, this basis (*past gross entry proceeds*) is defined as:

   The net amount of cash or cash equivalents received or the cash equivalent amount of other consideration received in exchange for incurring a liability, after deducting any fees or amounts paid for transaction-related goods or services.

17. The distinguishing characteristic of this basis is that it includes the prices of all goods and services directly related to the acquisition of an asset or liability, including those thought by some to be entity-specific, such as installation and preparation for use. The label “past gross entry price” is used to signal that this basis is nothing more than a “gross entry price” (as described in Measurement Paper 2A, paragraphs 24 and 30)) that was transacted in the past to acquire an asset presently owned by an entity.

18. As its label suggests, the past gross entry price basis refers to a past time frame. The actual inputs for this measurement basis are often taken from transaction documents or electronic
records such as an invoice. The past gross entry price basis is also a price, not a value. It represents a monetary amount for which two market participants actually exchanged an asset or liability, along with any amounts paid for transaction-related goods or services.

19. Examples of past gross entry price are common in financial statements today. For example, a company that acquires a multi-million dollar, four-story printing press currently records an amount that captures the exchange price of the equipment and any amounts paid (not already included in the exchange price) for shipping, taxes, legal fees, installation, and preparation for use (see SFAS 34, par. 6).

20. As another example, a company that issues debt and pays legal fees, document preparation fees, broker fees, and other such fees related to debt issuance currently records an amount equal to the proceeds of the loan itself less the fees for issuance services (which typically are netted against proceeds). Instead of expensing these issuance related fees immediately and recording the debt at its initial cash proceeds, the company records a lower, all-inclusive proceeds for the debt which results in a higher effective interest rate over the life of the debt (see APB 12, par. 16 and SFAS 91).

21. As a final example, a company that purchases a debt security as an investment with the intent to hold it until maturity initially records an amount equal to the exchange price paid for the debt security plus any broker commission or other trading fees incurred (SFAS 91, par. 5). In specific reference to investments, this measurement basis is sometimes referred to as investment value. The staff thinks the investment value label is equivalent to past gross entry price as defined in this section. It represents the price paid for an investment plus all amounts paid for trading related services, such as broker commissions.

*Accumulated past (gross) entry price*

22. The next historical measurement basis is *accumulated past (gross) entry price*. For assets, this basis is defined as:

The sum of all amounts of cash or cash equivalents paid or the cash equivalent amount of other consideration given to construct or assemble an asset over an
extended period of time, including those amounts paid or given for transaction-related goods or services.

For liabilities, this basis is defined as:

The amount of cash or cash equivalents received over a period of time in exchange for incurring multiple obligations or incrementally increasing an existing liability over an extended period of time.

23. The distinguishing characteristic of this basis is that it captures the prices paid in multiple transactions and accumulates them into one item over an extended period of time. The accumulated price basis results from a many-to-one allocation. The accumulated price basis differs from past gross entry price and past entry price in that the inputs for accumulated past entry price are captured from multiple transactions that occur over an extended period of time rather than from multiple transactions (e.g., purchase of item, transportation, taxes, etc.) that occur over a very short period of time, usually hours or days only.

24. For example, a company that constructs a building over a five year period (either for its own use or to sell) and subcontracts all of the work will transact for materials, labor, legal services, and taxes (to name just a few) during the lengthy construction process. The past gross entry prices of each of these transactions are accumulated into and reported as construction-in-process until the building is complete or sold. By the end of the construction process, the accumulated price basis is quite different from the past gross entry price that would be recorded if the same company purchased the identical building from a third party on the day construction ended. In part, this is because the past gross entry prices accumulated from transactions that occurred very early in the construction process are unlikely to be the same as the prices that would be paid today. This is also because the third party is likely to include some profit margin that is not reflected in the accumulated prices recorded by the self constructor in this example.

25. As an example of a liability that reflects accumulated proceeds, consider a line of credit held by a company. The balance reported for that line of credit at any given point in time represents the accumulation of multiple borrowing transactions over an extended period of time, as well as multiple principal-reduction transactions.
26. The accumulated past entry price basis represents the accumulation of multiple price-based transactions. However, that accumulated basis cannot be said to represent a single price for the resulting asset or liability because that one aggregated amount does not represent a monetary amount for which market participants actually exchanged the corresponding asset or liability. Nor is it likely that the accumulated basis represents the economic value of the asset or liability to the entity at a measurement date because some parts of the accumulated price are out of date, even when the asset is initially recorded. Regarding time frame, this basis clearly refers to the past by reporting an accumulation of past prices.

**Allocated past (gross) entry price**

27. The next historical measurement basis is *allocated past (gross) entry price*. For both assets and liabilities, this basis is defined as:

> The amount arrived at by allocating a past entry price or past gross entry price to multiple assets or liabilities.

28. A transaction price is often allocated to the assets and liabilities related to or encompassed by that transaction. For example, in a basket purchase of assets and liabilities (such as a business combination), the purchase price is not negotiated at the level of individual assets and liabilities. To assign amounts to those assets and liabilities, the basket purchase price must be allocated to all identifiable assets and liabilities. For example, if the basket purchase price is greater than the sum of the *fair values* of all identifiable assets and liabilities, that price is allocated among the assets and liabilities based on the best estimates of *fair value*, with the excess amount allocated to goodwill (see SFAS 141). The amounts assigned to individual assets and liabilities do not represent a price at which the individual assets and liabilities were transacted because the transaction itself is negotiated at a level which combines multiple assets and liabilities.

29. Another example of an allocated past entry price results from customer incentive and loyalty programs such as future purchase discount or point programs (EITF 00-22, IFRIC Draft Interpretation D20). While this issue is often considered from a revenue recognition perspective, the customer in such programs faces a parallel dilemma of determining how
much of the price paid in the present transaction relates to an additional item yet to be received. For example, if a company purchases an item from a vendor, and the vendor delivers the item along with a coupon for a 30 percent discount on the next purchase, the company has to determine what amount to assign to the purchased item. If the company concludes that the current transaction price represented partial payment for a future purchase, it might allocate the current transaction’s price across both items. This would result in an allocated past entry price basis for both items.

30. The allocated price basis differs from the accumulated price basis in that the price from one transaction is being allocated to the multiple assets and liabilities encompassed by that transaction. With the accumulated basis, the prices of multiple transactions are being accumulated into one item over an extended period of time. The allocated price basis results from a one-to-many allocation while an accumulated price basis results from a many-to-one allocation.

31. Despite this difference, the allocated price basis and accumulated price basis are similar in an important way. Like accumulated prices, an allocated price is not a price itself. Once a transaction price is allocated to constituent assets and liabilities, that allocated amount no longer represents a price. It is not a monetary amount for which market participants actually exchanged the asset or liability. Instead, it is simply the allocation of a transaction price to the multiple assets and/or liabilities encompassed by that transaction. Like an accumulated price basis, the allocated price basis cannot look to a past transaction for a precise determination of its price.

32. Although allocated past entry price is not a price itself, it is also not a value. It does not represent a subjective economic valuation or utility to the company, except by coincidence. As its label suggests, the time frame of allocated past entry price refers to the past. The basis is meant to report an aspect of the asset or liability that pertains to the past.
Amortized/Depreciated Price

33. The next basis is amortized/depreciated price, sometimes referred to as unexpired cost. For both assets and liabilities, this basis is defined as:

The amount of originally recorded price that remains after assigning some of that price to intervening accounting periods according to an accounting rule for amortization or depreciation.

34. This basis reflects the portion of the originally recorded price (which may be any of the bases previously discussed in this paper) that has not yet been assigned to an intervening period through a systematic depreciation or amortization process. When assigned to an intervening period, these originally recorded amounts may appear as an expense (in the case of long-lived assets or a discount on bond indebtedness), a reduction of an expense (in the case of a premium on bond indebtedness), a revenue (in the case of a discount on a bond investment), or a reduction of a revenue (in the case of a premium on a bond investment).

35. It is important to distinguish the amortized/depreciated price basis from the allocated price basis. With the allocated basis, the past entry price or past gross entry price of a transaction is allocated to multiple assets or liabilities related to or encompassed by that transaction. With the amortized/depreciated price basis, the amount originally recorded for an asset or liability is assigned to subsequent accounting periods as an expense or revenue (or reductions thereto). In this sense, the allocated basis and the amortized/depreciated basis are not the same, even though the word “allocate” is often used to describe the process whereby the price of an asset is assigned to subsequent periods. In short, the distinction between the two bases is simply that one allocates prices to particular assets and liabilities while the other allocates (or assigns) prices to particular periods.

36. Examples of depreciated or amortized price abound in financial statements. For example, equipment is reported at depreciated price, which is the amount arrived at after systematically assigning the originally recorded basis of the equipment to intervening accounting periods, either using straight-line depreciation or one of many accelerated depreciation methods (see
ARB 43, chap. 9). This amount may also reflect prior impairment charges (see IAS 16 and SFAS 144).

37. Another example of an amortized price basis is a zero-coupon bond. The issuer initially records the past gross entry proceeds of the issuance with a credit for the bond’s face amount and a discount representing all future amounts of interest yet to be incurred and recognized. As time passes, the issuer amortizes the bond discount by assigning some portion of it (typically using the effective interest rate method) to the intervening accounting periods as interest expense. At any given point in time, the amortized price of the bond is the amount of originally recorded past gross entry proceeds less the unexpired portion of the bond discount.

38. Although this basis is almost always associated with historical measurement bases, the basis actually refers to the past, present, and future. The price originally recorded for an asset obviously refers to a past time frame. However, the forecasted useful life of (for example) a depreciable asset refers to the asset’s future time frame. Moreover, the forecasted residual price of an asset may refer to the future time frame (for example, ARB 43, Chapter 9) or the present time frame (for example, IAS 16 par. 6 and IAS 38, par 8). In this sense, the time frame orientation of amortized/depreciated price can refer to all three time frames—the past, present, and future.

39. Amortized/depreciated price does not represent a price or an economic value. Once any amount of price originally recorded is amortized or depreciated, the resulting basis no longer represents a price—a monetary amount for which two market participants actually exchanged an asset or liability. Nor does the resulting basis represent a value in the sense of an entity-specific expression of economic worth. Even if the amortization/depreciation method corresponds closely to the actual pattern of diminution of economic worth of the asset, the resulting amortized/depreciated price would not necessarily represent a price (such as a current exit price for that asset) or a value.

**Combined Price**

40. The next historical basis is combined price. For assets and liabilities, this basis is defined as:
The amount arrived at through the combination of two or more of the following historical bases: past (gross) entry price, accumulated (gross) entry price, allocated price, or depreciated/amortized price.

41. This basis is purposefully distinguished from those preceding it to acknowledge that there are instances where two or more of the prior bases are used in conjunction with one asset or liability. For example, an entity may purchase a piece of equipment in a basket purchase, with the result that a portion of the basket purchase price is first allocated to the equipment and subsequently that allocated price is depreciated.

42. As another example of the combined price basis, consider the printing press example noted in the past gross entry price section of this memo (par. 19). If the company had installed the press itself using its own idle workers, then a combined price basis would result. The installed printing press would be recorded at the past gross entry price for the press and all transaction-related goods and services except installation. To that past gross entry price, the company would also add an amount representing an allocation from the workers’ wage price attributable to the time spent installing the press. At that point, the result is no longer a past gross entry price, but is instead a combined price.

43. The combined price basis does not represent a price because the combination of two or more other historical price bases does not represent a monetary amount for which two market participants exchanged the corresponding asset or liability (except by coincidence). Nor does the combined price basis represent an economic value, because its components do not all represent economic values. Because the combine price basis can be composed of two or more other historical measurement bases, and one or more of these bases may focus on the past, present, or future, the time frame orientation of the combined price basis can also focus on the past, present, or future.

**MISCELLANEOUS MEASUREMENT CONVENTIONS**

44. Present financial statements report a number of items for which no conceptual measurement basis seems to exist. Instead, the accounting standards for such items prescribe a computation
or calculation that often depends on other measured assets and liabilities within the financial statements.

45. An example of a measurement convention with no conceptual basis is the amount reported for goodwill. The accounting standard for goodwill prescribes a computation in which the amount paid or given for a company, less the amounts assigned to identifiable tangible and intangible assets (some based on current-value bases and others based on accounting conventions), is reported as goodwill (see IFRS 3 and SFAS 141).

46. Whether such mechanical computations should be defined as measurement bases is debatable. At this point in the measurement phase, the staff is taking a broad approach, considering both present practice and current proposals for measurement bases. At some later time, it is likely that some items will be eliminated from further consideration or evaluation.

ASSET AND LIABILITY DIFFERENCES

47. Before concluding, it is worth noting that most (if not all) assets can be associated with the historical measurement bases presented in this paper. In contrast, many liabilities recognized in financial statements do not fit neatly into any one of these historical bases. For example, the contingent liability resulting from an unsettled lawsuit cannot be measured using any of the bases in this paper, largely because there is no transaction price to which a company might look for an indication of past entry price, past gross entry price, accumulated price, or allocated price. Other examples of liabilities that would not fit neatly into any of the historical bases include pension obligations and post-retirement healthcare benefits (for which no transaction price between employer and employee exists). The fact that some liabilities do not fit neatly into the historical measurement bases of this paper perhaps only highlights that to measure something historically, a prior transaction with an observable price must have occurred.
SUMMARY

48. This paper labels, defines, and provides examples for six different historical measurement bases, as well as other measurement conventions used in financial statements today. It also explains the primary characteristics of each basis, describes them as prices or values (or neither), and indicates the time frame(s) to which each measurement basis refers. Exhibit A at the end of this memo summarizes these property descriptions for each basis. Exhibit B provides a graphic representation of all the historical measurement bases.
**EXHIBIT A:**

49. This exhibit lists each historical measurement basis described in this memo and indicates whether the basis represents a price, value, or neither and whether the basis refers to a past, present, or future time frame.

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<th>Measurement Basis</th>
<th>Price/Value Concept</th>
<th>Time Frame</th>
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<td>Price</td>
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<td><strong>Past entry price</strong></td>
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<td><strong>Accumulated past (gross) entry price</strong></td>
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<td>Price</td>
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EXHIBIT B:

50. This exhibit provides a graphical depiction of the measurement bases in this memo.

(1) Past entry price

- Machine

Ignores prices paid for transaction-related goods and services, such as transportation, legal fees, installation, etc.

(2) Past gross entry price

- Machine
- Transportation, legal fees, installation, commission,

Includes prices paid for transaction-related goods and services, such as transportation, legal fees, installation, etc.

(3) Accumulated past (gross) entry price

- Ventilation and Heating Transaction
- Elevator Systems Transaction
- Fixture Installation Transaction
- Plumbing work Transaction
- Electrical Work Transaction
- Materials Purchase Transactions

This basis is an accumulation of multiple transaction prices over an extended period of time.

The total of these transaction prices is not likely to equal what a company would pay to purchase the building in its completed form (which would be recorded at a past entry price or past gross entry price).

(4) Allocated past (gross) entry price

- Factory
  - Machine A
  - Machine B
  - Machine C
  - Machine D
  - Fixture A
  - Fixture B
  - Fixture C

This basis allocates a past (gross) entry price to multiple assets and liabilities encompassed by the transaction.

The price is typically negotiated at the "bundle" level (in this case, the factory level) so the transaction price gives no precise indication of the amount that was paid on an asset-by-asset basis.

The allocation itself is not a price.
(5) Amortized/Depreciated Price

The original basis (any of the above) is assigned to accounting periods based on some systematic depreciation or amortization method.

The amount assigned to a period is not a price itself, but is a carve out of the original basis, which could be any of the above bases. What remains after any amortization or depreciation is no longer a price either.

(6a) Combined price (accumulated basis and depreciated basis)

The combined price basis is the combination of any two of the above measurement bases. It is not a price itself.

This first example combines the accumulated past entry price basis with the amortized/depreciated price basis.

(6b) Combined price (allocated basis and depreciated basis)

This second example combines the allocated price basis with the amortized/depreciated price basis.