Financial Accounting Standards Board

International Accounting Standards Board

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INFORMATION FOR OBSERVERS

IASB/FASB Meeting:	**October 2006, Norwalk (Agenda Paper 2D; Memorandum 39)**
Project:	**Conceptual Framework**
Subject:	**Measurement 2A: Prices and Values (Agenda Paper 2D; FASB Memorandum 39)**

INTRODUCTION

1. Accounting owes many of its concepts and practices to the discipline of economics. That statement is particularly true with respect to accounting measurement, where the economic concepts of price and value underlie most of the items thought of as measurement bases. The purpose of this paper is to review and clarify those two concepts so that the discussion of measurement bases in Papers 2B and 2C may be better understood and appreciated.

2. [Paragraph omitted from Observer Notes].

PRICES AND VALUES

3. Scarcity of economic resources and the utility of those resources to individuals are concepts central to economics. However, the ability to directly use the concept of utility has long eluded economists. In the place of utility, economists have relied on two derivative concepts that capture the effects of utility, namely price and value. [Portion omitted from Observer Notes]

Values

4. In economics, *value* is an assessment in monetary terms of the worth of a good[1] or service to an individual relative to the worth of other goods or services. Value is subjective; it is based on a particular individual's utility for that good or service. Nevertheless, the individual can usually quantify a value in some way and communicate that quantification to others. That communication can then be observed by others, but is not to be confused with the value itself.

5. In accounting, the term *value* is widely used, but not all usage refers to value in the economic sense. *Investment value* and *value in use* are examples of legitimate economic use of the term value. On the other hand, *current value* and *fair value* may or may not refer to something that truly is a value, and *book value*, *entry value*, and *exit value* are accounting concepts that do not describe values at all. Other terms used in accounting incorporate the word value as well, but the staff's purpose here is only to illustrate that accountants tend to use the term *value* loosely, obscuring the differences between values and other things, including prices.

6. [Paragraph omitted from Observer Notes].

Prices

7. [Portion omitted from Observer Notes]. A *price* is the amount of money sacrificed in exchange in order to purchase a good or service. Since an exchange always involves at least two parties, a price may also be described as the amount of money

[1] This paper uses the term *good* as an economic cognate for the accounting term *asset*. Thus, it includes not only tangible items but intangibles, including rights, as well.

received in exchange on the sale of a good or service. Whereas values may be thought of as utility or worth ratios, prices are exchange ratios. Prices are also sometimes described as opportunity costs, because they are indications of the amount of monetary wealth that is forgone to acquire an asset or the amount of monetary wealth that is forgone to hold, rather than dispose of, an asset.

8. In contrast to values, which are subjective, prices are objective. They may result from interaction between marketplace participants with different, subjective values for the good or service exchanged, but the result is something objective and observable, at least by the parties to the exchange and perhaps to others if information about the exchange is made public.

9. Not all monetary amounts labelled *price* are actual prices. In the staff's view, a price is not a price until it has been **transacted**. **Quoted** prices, such as bid and ask prices, or advertised retail prices, are **values** of those who set them. Quoted prices represent amounts at which economic actors would like to transact business, but at the time of the quote they remain untransacted and subject to change. Other amounts labelled *price* that lack the objectivity of transacted prices include **estimated** prices and **hypothetical** prices.

10. The term *price* is not used as widely in accounting as the term *value*. [Portion omitted from Observer Notes]. Nevertheless, there appears to be some confusion in discussions of prices as measurement bases. [Portion omitted from Observer Notes].

11. **ENTRY AND EXIT PRICES vs. ENTRY AND EXIT VALUES**

12. In general, there are two kinds of prices, entry (or purchase) prices and exit (or selling) prices. From the perspective of an exchange transaction, the entry price and the exit price are the same. Thus, when an entity purchases an asset, the entity's entry price equals the seller's exit price. However, from the perspective of the entity as a measurer of its owned assets, rather than as a purchaser of a non-owned asset or seller of an owned asset, entry price and exit price differ in concept and may or may not differ in amount. [Portion omitted from Observer Notes].

13. Terminology used to discuss entry and exit prices as measurement bases varies. The terms entry **price** and entry **value** are sometimes used interchangeably. Often, however, entry price and entry value refer to two somewhat different concepts. The same may be said for exit **price** and exit **value**: sometimes they are used interchangeably, but often they are not. [Portion omitted from Observer Notes].

14. [Paragraph omitted from Observer Notes].

Entry and Exit Prices

15. As a measurement basis, the *entry price* of an entity's asset is the price that the entity would have to pay to acquire that asset at the measurement date if it did not own it. The language "would have to" may make entry price sound hypothetical in the measurement context, but that is not so. In the simplest case, an entity can measure the entry price of its asset by identifying an identical asset that it does not own for which a price was paid in exchange on the entity's measurement date. The entry price of the exchanged asset can then be imputed to the entity's asset. That price is actual, not hypothetical.

16. Likewise, exit price as a measurement basis is the price that the entity would receive for its asset on the measurement date if it sold rather than kept it. The exit price of an entity's asset can be found by identifying an identical asset that was sold on the measurement date and imputing the exit price of the exchanged asset to the entity's owned asset. Again, that price is actual, not hypothetical.

17. [Portion omitted from Observer Notes]. In principal, the entry price and exit price of a particular owned asset at a particular time are equal.

18. In practice, those prices may differ or may appear to differ. Potential sources of differences between entry and exit prices include market imperfections, the bundling of goods and services into a single package with one price, and the availability of more than one entry or exit price for a particular asset.

19. [Paragraph omitted from Observer Notes].

20. [Paragraph omitted from Observer Notes].

21. [Paragraph omitted from Observer Notes].

22. [Paragraph omitted from Observer Notes].

23. [Paragraph omitted from Observer Notes].

Entry and Exit Values

24. When they are not used as synonyms for entry and exit price, the concepts of entry and exit value are more complex. Neither entry value nor exit value is a value in the economic sense previously discussed. Both may be described as prices or, perhaps more accurately, as price aggregates.

25. The entry value of an owned asset is comprised of its entry price, as described in paragraph 14, **plus** the prices of all additional goods and services that would be required to give the asset the same location and utility that the already-owned asset has at the measurement date. [Portion omitted from Observer Notes].

26. All additional goods and services should be considered when measuring the entry value of an owned asset, even though an entity might elect to forgo one or more of them in an actual purchase. [Portion omitted from Observer Notes].

27. Conversely, the exit value of an owned asset equals its exit price as described in paragraph 15 above **less** the prices of any goods or services that would be required to sell that asset at the measurement date. [Portion omitted from Observer Notes]. As with entry value, even though an entity might choose to perform an exit service itself in an actual asset disposition, the measurement of the exit value of an asset that is still held includes arm's-length prices for all required disposition services.

28. If the descriptions of entry and exit prices are compared with those of entry and exit values, it should be apparent that the two **values** will usually differ for a particular asset of an entity, even if the two **prices** do not. Typically, there is at least one transaction cost that will result in a difference between entry value and exit value. [Portion omitted from Observer Notes].

Suggested Terminology Change

29. [Paragraph omitted from Observer Notes].

30. Before leaving the topic of entry and exit prices and values, however, the staff proposes a change in terminology. [Portion omitted from Observer Notes]. the staff proposes that the terms *entry value* and *exit value* be replaced with new terms for purposes of the conceptual framework project. [Portion omitted from Observer Notes].

31. The staff suggests replacing the term *entry value* with the term *gross entry price*. [Portion omitted from Observer Notes]. In a similar vein, the staff suggests replacing the term *exit value* with that of *net exit price*, which captures the notion that the latter equals an asset's exit price less related incidentals, such as transactions costs. The staff uses the word *price* in both those terms to be consistent with the price/value distinction made in this paper, as well as to facilitate later analysis. At the same time, the staff is aware that accountants may find gross entry price to be similar to the notion of total acquisition cost and net exit price to be similar to the notion of net realizable value.

PRICES, VALUES, AND TIME

32. In theory, any asset can have a price or value in any of three time frames–the past, the present, or the future. Stated another way, a particular price or value for any asset may be of a different amount and nature depending on whether that price or value occurred in the past, exists presently, or is forecast to occur in the future.[2]

33. Not all measurement bases envision a past, present, and future version. Nor do all measurement basis labels clearly indicate the time frame to which they relate. Nevertheless, thinking about the time frame specified or implied by a measurement

[2] In its reference to time frames, the staff acknowledges the widely-held philosophical view that the present as a time frame is a fiction, that every event either has occurred already or has yet to occur. Nevertheless, the staff thinks it useful to adopt the common notion of the present as encompassing the very recent past and the very immediate future. That common notion certainly underlies the use of the terms *present* and *current* by accountants.

basis may help to discriminate more clearly between the qualities of that basis and other bases.

34. To the extent possible, Papers 2B and 2C will classify each existing or proposed measurement basis that is discussed as either a price or a value. Furthermore, those papers will attempt to classify each measurement basis according to the time frame to which it refers. The staff thinks that the relationship of a measurement basis to price or value, as well as to time frame, may provide insights that will help the Boards and staff evaluate that basis in the second milestone of the measurement phase of the conceptual framework project.

35. The following table illustrates the scheme that will be used to classify proposed measurement bases according to worth indicator and time properties:

		Time Frame		
		Past	Present	Future
Worth Indicator	Value	Past value	Present value	Future value
	Price	Past price	Present price	Future price