Financial Accounting Standards Board

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INFORMATION FOR OBSERVERS

IASB/FASB Meeting:	**23 October 2006, Norwalk (Agenda Paper 2F; Memorandum 41)**
Project:	**Conceptual Framework**
Subject:	**Measurement 2C: Current and Future Measurement Bases (Agenda Paper 2F; FASB Memorandum 41)**

INTRODUCTION

1. The purpose of this paper is to:

    a. label and define the measurement bases for assets and liabilities that comprise the current and future measurement bases;

    b. provide examples of each basis; and

    c. classify the bases according to their relationship to price and value, as well as their time frame orientation.

2. As with the historical cost bases paper, the staff utilized a number of sources to draft this paper. Please see paper 2B, paragraph 2, for those sources.

ORGANIZATION OF THE PAPER

3. This paper is divided into three sections, as follows:

   a. Current Measurement Bases

      (1.) Current entry prices (of assets and liabilities):

         (a.) Current identical reproduction entry price (of an asset);

         (b.) Current identical replacement entry price (of an asset);

         (c.) Current equivalent replacement entry price (of an asset);

         (d.) Current replacement productive capacity entry price (of an asset); and

         (e.) Current consideration amount (of a liability)

      (2.) Current exit price (of an asset or a liability)

      (3.) Current equilibrium price (of an asset or a liability)

      (4.) Current net exit price (of an asset)

      (5.) Current gross exit price (of a liability)

      (6.) Value-in-use (of an asset or a liability)

      (7.) Deprival value (of an asset)

      (8.) Relief value (of a liability)

   b. Future Measurement Bases

      (1.) Future net exit price (of an asset)

      (2.) Most likely future amount (of an asset or a liability)

   c. Exhibit A

CURRENT MEASUREMENT BASES[1]

Current Entry Prices (of assets and liabilities)

[1]The term *value* is used in the heading of this section because of its common use. However, most of the measurement bases described in this section are prices. For a discussion on the distinction between the concepts of *price* and *value*, please see paper 2A.

4. This section of the paper examines *current entry prices* and the measurement bases which have been historically linked to them: *current cost, replacement cost* and *reproduction cost.* Many terms have been associated with the notion of current cost. Current cost has been referred to as *current cost of replacement, current replacement cost, replacement cost, replacement value, input price, entry price, replacement market price* and *current entry value.* The IASB and FASB frameworks currently define *current cost*[2] similarly to represent:

> The amount of cash or equivalents that would have to be paid if the same or an equivalent asset was acquired currently.

5. The IASB has used *current cost* sparingly in its standards. *Current cost* appears in three IASB standards and is most commonly associated with IAS 29, *Financial Reporting in Hyperinflationary Economies.* The FASB has used *current cost* in a number of its standards, most notably in FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, FASB Statement No. 52, *Foreign Currency Translation,* and FASB Statement No. 89, *Financial Reporting and Changing Prices*.

6. More recently, the IASB Discussion Paper proposed to define[3] current cost as:

> The most economic cost of an asset or of its equivalent productive capacity or service potential.

7. Current cost is a broad notion which represents the *current gross entry price* of the item being measured (either the specific asset itself or the productive capacity that the asset provides). The measurer determines this price by considering how much it would cost the entity to replace the item. Therefore, it is not surprising that current cost has commonly been used interchangeably with replacement cost. However, because an asset has more than one characteristic that can be replaced, appropriate labels are needed to capture these characteristics.

[2] IASB Framework, paragraph 100(b) and FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, paragraph 67(b).
[3] IASB Discussion Paper, Measurement Bases for Financial Accounting: Measurement on Initial Recognition, paragraph 82.

8. There are predominantly two characteristics of an asset that could be replaced - the **specific features that comprise the asset** (that is, the asset itself) or the **functioning purpose of the asset** (that is, the productive capacity of the asset). [Portion omitted from Observer Notes].

9. The distinction between replacing an asset and its productive capacity is a function of the type of information that is desired. If information about the asset actually employed in operations is desired, then replacement of the asset itself is appropriate. In that case, any subsequent technological changes are not considered because the asset being measured does not possess the newer technology. In order to evaluate the efficiency of current operations as they are, information about the return generated by those assets in current use is needed. Alternatively, some might desire information about how the cost of productive capacity would be affected if replaced with current technology. Advocates of this view reason that the resulting information is more predictive, and therefore more useful, because factors such as the long-range business plan, obsolescence and availability of low-cost energy are considered.

Replacement of the actual asset without consideration of technological changes

10. An actual asset can be replaced by one of two types of assets – an identical asset or an equivalent asset. Some refer to the gross entry price of an asset that is being considered for replacement by an identical asset as *reproduction cost.* The IASB and FASB have neither defined nor used reproduction cost in their frameworks and standards. However, the following definition has been proposed in the IASB Discussion Paper:

> The most economic current cost of replacing an existing asset with an identical one.

11. [Paragraph omitted from Observer Notes].

12. However, the label *reproduction cost* suggests the creation of another asset, even though what is meant by reproduction cost is either the reproduction or acquisition of

an identical asset. For clarity, therefore, the staff proposes to replace *reproduction cost* with two terms–*current identical reproduction entry price* and *current identical replacement entry price.*

13. *Current identical reproduction entry price* and *current identical replacement entry price* are defined as follows:

> *Current identical reproduction entry price*: The current gross entry price of replacing an existing asset with an identical one by reproduction.
>
> *Current identical replacement entry price*: The current gross entry price of replacing an existing asset with an identical one by purchase.

14. In contrast, an equivalent replacement asset possesses features that are similar – but not identical - to those of the asset being replaced. An equivalent replacement asset cannot possess technology that is newer than the technology of the actual asset being replaced. [Portion omitted from Observer Notes]. The equivalent replacement asset would possess the most similar features as compared to other potential replacement assets. [Portion omitted from Observer Notes].

15. Some have used *replacement cost* when referring to the replacement of an asset with an equivalent asset, while others have referred to the replacement of productive capacity. The IASB Discussion Paper proposes the following definition of *replacement cost*:

> The most economic current cost of replacing an existing asset with an asset of equivalent productive capacity or service potential.

16. The IASB Framework does not define *replacement cost*, but the term appears in the basis for conclusions in IAS 2 and IAS 36. The FASB framework does not explicitly define *replacement cost* but the term *replacement* appears in parentheses in the CON 5 definition of *current cost*, which suggests that *current cost* and *replacement cost* are synonymous although, as noted earlier, *current cost* and *replacement cost* are not

synonyms. *Replacement cost* can be found in at least ten FASB standards, including SFAS 19, 52 and 141.

17. In order to avoid confusion, the staff proposes to use the label *current equivalent replacement entry price* to represent:

> The current gross entry price of replacing an existing asset with an equivalent (but not identical) asset.

Replacement of the productive capacity of the asset while considering the effects of technological changes

18. The cost of replacing the productive capacity of an asset considers the effects that technological improvements have on productive capacity. [Portion omitted from Observer Notes].

19. [Paragraph omitted from Observer Notes].

20. [Paragraph omitted from Observer Notes].

21. In order to distinguish a productive capacity notion of replacement cost from related notions, the staff proposes to use the label *current replacement productive capacity entry price* to represent:

> The current gross entry price of replacing the productive capacity of an existing asset with the most current technology available.

Replacement of a liability

22. Unlike an asset, which has two characteristics that could be replaced (that is, the asset itself or the asset's productive capacity), a liability has one characteristic that could be replaced–the liability itself. Accounting literature has very little discussion with regard to replacement of a liability. The FASB has neither defined the notion of measuring a liability nor used it in its standards. The IASB Framework applies the notion of current cost to liabilities as:

> The undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

23. Others have referred to this notion as the *replacement loan amount, current equivalent proceeds,* and *current proceeds.* The IASB Discussion Paper labels this notion *current consideration amount*, which it defines as:

> The fair value of the consideration that the owing party would have received if the liability had been incurred by it on the measurement date.

24. The staff agrees with this notion except for the use of "fair value", because fair value by itself is a potential measurement basis. In order to avoid confusion, the staff proposes to use *current consideration amount* to represent:

> The amount of consideration that the owing party would receive if it incurred the liability on the measurement date.

Current exit price (of an asset or a liability)

25. As defined in paragraph 15 of paper 2A, the *current exit price* of an asset represents the "price that the entity would receive for its asset at the measurement date if it sold rather than kept it." For a liability, the current exit price represents the amount, in cash, that the holder would have to pay to currently eliminate the liability. A liability could be eliminated either through settlement (that is, paying off the liability to the counterparty) or transferring it to a third party[4].

26. This measurement is intended to provide information about the asset or the liability that the entity **currently holds**; rather than about an asset or a liability that the entity **might hold in the future**. Therefore, this notion measures the *current state* of the attributes of an asset (that is, its current condition and/or location) or of a liability (that is, any restrictions). For many assets, this distinction may not be pertinent

[4] [Footnote omitted from Observer Notes].

because they can be sold as is. However, some assets, such as raw materials and work-in-process inventories, require further processing and transportation. The "current state" distinction clarifies that estimated costs to further process and transport the asset should not be considered. This notion assumes that the transacting parties are unrelated market participants that exchange the asset or liability in an **orderly transaction**–not a forced transaction (for example, a forced liquidation or distress sale).

27. The current state notion should not be interpreted to imply that current exit price is "scrap value." [Portion omitted from Observer Notes].

28. Also under this notion, the measurer should not use the *retail exit price* as the current exit price. [Portion omitted from Observer Notes].

29. [Paragraph omitted from Observer Notes].

30. [Paragraph omitted from Observer Notes].

31. [Paragraph omitted from Observer Notes].

32. [Paragraph omitted from Observer Notes].

33. The term *current exit price* does not appear in the existing IASB or FASB literature. However, on September 15, 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*, in which *fair value* is a current exit price. That statement was being issued to address the different meanings of *fair value* in FASB standards. The IASB Discussion Paper also defines *fair value* but not as a current exit price. To avoid confusion, the staff proposes to use the term *current exit price*.

34. *Current exit price* is defined as:

> The price that would be received to sell an asset or paid to eliminate a liability in an orderly transaction between market participants at the measurement date.

Current equilibrium price (of an asset or a liability)

35. The term *current equilibrium price* has been referred to as *fair value* in the IASB Discussion Paper. *Current equilibrium price* represents a single equilibrium price for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm's-length transaction conducted in an efficient, complete, and perfect market. This price is neither an exit price nor an entry price because those prices are derived from actual markets and can be observed. The equilibrium price is a hypothetical and unobservable because the market which it is derived from does not exist in the real world.

36. The IASB Discussion Paper defines *fair value* as:

> The amount for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm's length transaction.

37. The "amount" is intended to represent the equilibrium price described above. The staff proposes to use the term *current equilibrium price* and define it as:

> The single equilibrium price for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm's-length transaction conducted in an efficient, complete, and perfect market.

Current net exit price (of an asset)

38. As defined in paragraph 26 of paper 2A, *current net exit price* represents an asset's current exit price less related incidentals, such as transaction costs. Many labels have been used to connote current net exit price. The IASB Framework uses the label *realisable value*[5] and CON 5 uses *current market value* to represent:

[5] "Realisable value" appears in one IASB standard – IAS 41, *Agriculture*, paragraph B18.

> The amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly liquidation.

39. FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, clarifies that "current market value" existed within the definition of *current exit value in orderly liquidation*, which represents:

> The net amount of cash that could be obtained currently by selling the asset in orderly liquidation (current market value, if a market exists).[6]

40. The SFAS 19 notion of *current market value* has also been referred to as the *current cash equivalent.* For clarity, the staff proposes to replace these labels with *current net exit price*. *Current net exit price* is defined as:

> The total amount of cash, or its equivalent, that could be received currently for the immediate sale of an asset in orderly liquidation.

Current gross exit price (of a liability)

41. The term *current gross exit price* represents the total amount of cash that would be required to currently settle a liability with a counterparty or transfer a liability to a third party. Said another way, this amount represents the *current exit price* of a liability adjusted for transactions costs.

42. [Paragraph omitted from Observer Notes].

43. The FASB framework does not define this notion of measurement. Some accountants have referred to this notion as the *cost of release*. The IASB Framework uses the label *settlement value* to represent:

> The undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

[6] SFAS 19, paragraph 122(b).

44. The staff proposes to use the term *current gross exit price* and define it as:

> The total amount of cash, or its equivalent, that would be paid currently to eliminate a liability.

Value-in-use (of an asset or a liability)

45. The term *value-in-use* represents the discounted net cash flows that the entity expects to receive for the most profitable use of an asset that is available to the entity. As the asset is used in the future, it will provide cash inflows to the entity and require cash outflows. Discounting is used to convert the forecast future cash inflows and outflows into an amount that represents what the asset is worth to the entity at the present time. Value-in-use is considered to be a *value* not only because the forecasts of cash flows are specific to the entity but also because the discount rate is determined by the entity; the rate is in the "eye of the beholder". The rate could be the risk free rate, internal rate of return, cost of capital, or another rate which the entity finds appropriate.

46. FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, provides guidance for using present value techniques. That guidance focuses on a traditional or discount rate adjustment technique and an expected cash flow (expected present value) technique.

47. CON 5 uses the term *present (or discounted) value of future cash flows* to mean "value-in-use". CON 5 defines *present (or discounted) value of future cash flows* as:

> The present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows[7].

[7] FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 67(e).

48. The notion of *value-in-use* is defined three ways in IASB accounting literature. The IASB Framework uses the term *present value* and IFRS 5 and IAS 36 use the *value-in-use*. Those terms are defined as follows::

> Framework: The present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. The present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business[8].
>
> IFRS 5: The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life[9].
>
> IAS 36: The present value of future cash flows expected to be derived from an asset or cash-generating unit[10].

49. The IASB Discussion Paper defines *value-in-use* of an asset as:

> The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life[11].

50. The staff proposes to retain the term *value-in-use* and define it as:

> The discounted net cash flows that the entity expects to receive for the use of an asset or pay to settle or transfer a liability.

Deprival value (of an asset)

51. The term *deprival value* represents the value that an entity would lose if it were deprived of an asset. That determination provides information about the value that

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[8] IASB Framework, paragraph 100(c).
[9] IFRS No. 5, *Non-current Assets Held for Sale and Discounted Operations*, Appendix A.
[10] IAS 36, *Impairment of Assets*, paragraph 6.
[11] IASB Discussion Paper, *Measurement Bases for Financial Accounting – Measurement on Initial Recognition*, paragraph 86.

the asset provides the business. Therefore, it is not surprising that *deprival value* has also been referred to as *value to the business.* Typically, an asset is acquired because the entity expects the asset to provide an acceptable future rate return that exceeds its cost (that is, the cost of replacing the asset[12] is less than its value-in-use). In those circumstances, if the entity were deprived of the asset it would replace the asset, establishing a "ceiling" for deprival value.

52. On occasion, the asset might be impaired and therefore not justify replacement. [Portion omitted from Observer Notes]. The entity could either **continue to use the asset** (measured by the asset's *value-in-use*) or **sell the asset** (measured by the asset's *current net exit price*). The measurement basis of the alternative chosen has been referred to as the asset's *recoverable amount.*

53. [Paragraph omitted from Observer Notes].

54. The term *deprival value* is not defined or used in IASB or FASB literature. The IASB Discussion Paper defines *deprival value* as:

> The loss that an entity would suffer if it were deprived of an asset. It is the lower of replacement cost and recoverable amount on the measurement date, with recoverable amount being the higher of value in use and net realizable value.

55. The staff proposes retaining the term *deprival value* and to define it as:

> The value that an entity would lose if it were deprived of an asset.

The relief value (of a liability)

56. The term *relief value* represents the amount by which an entity would be better off if it were relieved of a liability. This amount is the higher of the liability's *current consideration amount* or *settlement amount*.

[12] Such cost can be measured using the asset's: current identical reproduction entry price, current identical replacement entry price, current equivalent replacement entry price or current replacement productive capacity entry price.

57. At the time a liability is incurred, the consideration received typically represents the burden of the liability to the entity (measured by the liability's *current consideration amount*). If the entity were relieved of that burden on that date, it would be better off by the amount of consideration it received.

58. [Paragraph omitted from Observer Notes].

59. However, a liability might be settled at an amount greater than the *current consideration amount*. [Portion omitted from Observer Notes]. In those circumstances, rational economic behavior would lead the entity to choose the alternative that results in the lowest payout (commonly referred to as the *settlement amount*). Generally, the cost of performance will be less than the cost of release. However, if the customer is willing to grant release on favorable terms to the entity, the cost of release will be less than the cost of performing.

60. The term *relief value* is not defined or used in IASB or FASB literature. The IASB Discussion Paper defines *relief value* as:

> The higher of a liability's current consideration amount and repayment amount, with repayment amount being defined as the lower of the current cost of performance and the current cost of release from the liability[13].

61. The staff proposes retaining the term "relief value" and to define it as:

> The amount by which an entity would be better off if it were relieved of a liability.

FUTURE MEASUREMENT BASES

Future net exit price (of an asset)

62. The term *future net exit price* represents the net amount of cash that an entity expects to receive for the disposal of an asset in the future. This measurement is intended to provide information about an existing asset by estimating its future selling price and

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[13] IASB Discussion Paper, *Measurement Bases for Financial Accounting – Measurement on Initial Recognition*, paragraph 96.

deducting the future costs to complete and future transaction costs. This distinction is pertinent when measuring unfinished assets, such as raw material and work-in-process inventory, because an unfinished asset is not the same as a finished asset.

63. [Paragraph omitted from Observer Notes].

64. The entity predicts the amount required to finish the car based on assessments of expected future cash flows. The time value of money is ignored because that would convert expected future cash flows into a current value amount which is not the intended purpose of this measurement.

65. Sometimes *future net exit price* has been referred to as *expected value in due course of business,*[14] *expected value, net selling value, net market value,* and the *non-discounted amount of expected cash outlay*. The IASB, FASB and IASB Discussion Paper use the term *net realizable value* as:

> IASB and IASB Discussion Paper: The estimated selling price in the ordinary course of business less the estimated costs of completion and the costs necessary to make the sale[15].
>
> FASB: The nondiscounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion[16].

66. *Net realizable value* is commonly associated with the measurement of accounts receivable and inventories as permitted by Chapter 4, Inventory Pricing, of Accounting Research Bulletin No. 43, and IAS 2, *Inventories*. Sometimes *net realizable value* has been used to mean *current net exit price*. In order to avoid confusion that might result from having one label being associated with two

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[14] FASB Discussion Memorandum, *Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement*, (December 1976).
[15] IASB Glossary of Terms and IASB Discussion Paper, *Measurement Bases for Financial Accounting – Measurement on Initial Recognition*, paragraph 84.
[16] FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 67(d).

meanings, the staff proposes to replace the term *net realizable value* with *future net exit price*.

67. *Future net exit price* is defined as:

> The net amount of cash, or its equivalent, that an entity expects to receive for the future disposal of an asset converted in due course of business.

Most likely future amount (of an asset or liability)

68. For an asset, the term *most likely future amount* represents an undiscounted amount of cash inflows that an entity expects will be provided by an asset. For a liability, *most likely future amount* represents an undiscounted amount of cash outflows that the entity expects will be required to settle a liability. The amount is expected to be unbiased and represent a single amount or point estimate that is most likely to occur in a range of possible outcomes. Because the amount is undiscounted, it provides no information about the timing and uncertainty of the estimate.

69. [Paragraph omitted from Observer Notes].

70. [Paragraph omitted from Observer Notes].

71. *Undiscounted expected amount* has also been referred to as *best estimate* and *expected outcome*. The IASB, FASB and IASB Discussion Paper do not define *undiscounted expected amount*. The staff proposes to use the term *most likely future amount* rather than the other terms because the measurement represents an **amount** that is assigned to an expected outcome. The *most likely future amount* for an asset and a liability is defined as follows:

> Asset: an undiscounted amount of cash inflows that an entity expects will most likely be provided by an asset.
>
> Liability: an undiscounted amount of cash outflows that an entity expects will most likely be incurred on a liability.

EXHIBIT A:

This exhibit lists the current and future measurement bases described in this paper and indicates whether each basis is a price, value or neither and its time frame.

Measurement Basis	Price/Value Concept			Time Frame	
	Price	Value	Neither	Present	Future
Current identical reproduction entry price (of an asset): The current gross entry price of replacing an existing asset with an identical one by reproduction.	✓			✓	
Current identical replacement entry price (of an asset): The current gross entry price of replacing an existing asset with an identical one by purchase.	✓			✓	
Current equivalent replacement entry price (of an asset): The current gross entry price of replacing an existing asset with an equivalent (but not identical) asset.	✓			✓	
Current replacement productive capacity entry price (of an asset): The current gross entry price of replacing the productive capacity of an existing asset with the most current technology available.	✓			✓	
Current consideration amount (of a liability): The amount of consideration that the owing party would receive if it incurred the liability on the measurement date.	✓			✓	
Current exit price (of an asset or a liability): The price that would be received to sell an asset or paid to eliminate a liability in an orderly transaction between	✓			✓	

Measurement Basis	Price/Value Concept			Time Frame	
	Price	Value	Neither	Present	Future
market participants at the measurement date.					
Current equilibrium price (of an asset or a liability): The single equilibrium price for which an asset or liability could be exchanged between knowledgeable, willing parties in an arm's-length transaction conducted in an efficient, complete, and perfect market.		✓		✓	
Current net exit price(of an asset): The total amount of cash, or its equivalent, that could be received currently for the immediate sale of an asset in orderly liquidation.	✓			✓	
Current gross exit price (of a liability): The total amount of cash, or its equivalent, that would be paid currently to eliminate a liability.	✓			✓	
Value-in-use (of an asset or a liability): The discounted net cash flows that the entity expects to receive for the use of an asset or pay to settle or transfer a liability.		✓		✓	
Deprival value (of an asset): The value that an entity would lose if it were deprived of an asset.	✓	✓		✓	
Relief value (of a liability): The amount by which an entity would be better off if it were relived of a liability.	✓			✓	
Future net exit price (of an asset):	✓				✓

	Price/Value Concept			Time Frame	
Measurement Basis	**Price**	**Value**	**Neither**	**Present**	**Future**
The net amount of cash, or its equivalent, that an entity expects to receive for the future disposal of an asset converted in due course of business.					
Most likely future amount (of an asset or a liability): *Asset:* An undiscounted amount of cash inflows that an entity expects will most likely be provided by an asset. *Liability*: an undiscounted amount of cash outflows that an entity expects will most likely be incurred on a liability.			✓		✓