Financial Accounting Standards Board

International Accounting Standards Board

401 Merritt 7, PO Box 5116, Norwalk, CT 06856, USA
Tel: +1 203 847 0700
Fax: +1 203 849 9714
Website: www.fasb.org

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410
Fax: +44 (0)20 7246 6411
Website: www.iasb.org

INFORMATION FOR OBSERVERS

IASB/FASB Meeting:	**23 April 2007, London**
Project:	**Conceptual Framework**
Subject:	**Measurement 4: Measurement Basis Candidates and Other Milestone 1 Issues (Agenda paper 14)**

INTRODUCTION

1. At the October 2006 joint meeting, the staff presented an inventory of measurement basis candidates (Issue M01) for evaluation in Milestone II of the measurement phase (Phase C) of the conceptual framework (CF) project. The staff also addressed Issues M02 and M03 (see Appendix A for a list of revised Phase C issues).[1] Although the October meeting was

[1] The staff discussed issues M01 through M03 in three papers at the October joint meeting, namely *Measurement 2A: Prices and Values* (FASB Memorandum 39, IASB Agenda Paper 2D), *Measurement 2B: Historical Measurement Bases* (FASB Memorandum 40, IASB Agenda Paper 2E), and *Measurement 2C: Current and Future*

a non-decision-making meeting in preparation for the measurement roundtables that were held in January and February, 2007, Board members provided suggestions for improving the inventory of measurement bases.

2. At the separate meetings of the Boards in March, the staff presented a summary of participant comments from the roundtables as well as a plan for using those comments. The roundtables summary contained several suggestions for improving the staff's work on Milestone I that were incorporated into the follow-up plan. In general, the Boards approved of the staff's plan.

3. In this paper, the staff revisits the measurement basis candidates, having considered comments and suggestions from the Boards and roundtable participants. The staff also presents its analysis of issues M04 and M05, which were not part of the October 2006 discussions. The remainder of this paper is organized according to the five Milestone I measurement issues.

ISSUE M01: ***What are the measurement basis candidates?***

4. At the measurement roundtables, various participants commented that the staff's inventory of measurement basis candidates was too lengthy. Some participants thought that dividing historical cost into several separate bases was artificial; others thought that many of the bases were simply variants of a smaller number of more fundamental bases. Although roundtable participants did not agree in detail, they did agree that the inventory of bases could be improved by grouping the bases into so-called families. A similar suggestion was made by some Board members at the October joint meeting.

5. [Paragraph omitted from observer notes]

6. A final comment from some Board members was that the use of the terms *gross* and *net* to distinguish entry and exit prices that ignored or included related costs was confusing. The confusion was made worse by the fact that those terms were applied in an opposite manner

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Measurement Bases (FASB Memorandum 41, IASB Agenda Paper 2F). The staff has used footnotes in this paper to recall certain points from the October papers, but some Board Members may wish to review parts of those papers for more detail on the original discussions.

with respect to assets and liabilities. Thus, the staff called an entry price for an asset that included related costs a *gross entry price* (because the amount paid for the asset and the related costs are totalled), while the entry price for a liability that included related costs was termed a *net entry price* (because the proceeds from incurring the liability and the related costs are netted). Conversely, the exit price for an asset that included related costs was called a *net exit price*, and the exit price for a liability that included related costs was called a *gross exit price*.[2]

7. The staff agrees with all the above suggestions and has incorporated them in a revised list of measurement basis candidates. That revised list is reproduced in Appendix B.

8. Note that the staff now proposes nine primary measurement bases as candidates for evaluation in Milestone II of Phase C of the CF project. By grouping the former inventory into those nine primary bases, the staff has been able to rely almost exclusively on the terms *price* and *value* in its choice of labels. Focusing on the primary bases rather than their variants has also enabled the staff to eliminate the use of the terms *gross* and *net* in relation to acquisition and disposal costs of assets and incurrence and elimination costs of liabilities. The staff thinks that most of the analysis planned for Milestone II can be performed using the primary bases, with only occasional references to their variants.

9. The revised inventory may be summarized as including entry and exit prices in their past, present, and future forms (six primary bases), plus *modified past entry amount*, *current equilibrium price*, and *value in use.* Including variants, 21 bases are represented. The original inventory comprised 19 bases (see Appendix C). The difference can be explained as follows. Four bases have been added, namely *past exit price* (in two variants) and *future entry price* (also in two variants), while two candidate bases have been eliminated, *deprival value* and *relief value*. In addition, *current entry price* (without related costs) has been

[2] Recall that the related costs referred to here include not only transaction costs but also other costs related to the acquisition or disposal of assets and the incurrence or extinguishment of liabilities. Examples of those other costs are attorneys' fees, taxes, transportation costs, and installation costs. As used here, however, related costs do not include various allocations of overhead or other costs previously incurred by an entity that accountants sometimes capitalize into the total cost of assets. Thus, an entry or exit price with related costs is a price aggregate. In many situations that price aggregate may be unique to the entity, but it is still a price determined by market factors, not an entity-specific value. Another entity in the same position would be expected to receive or pay that same price.

added and *current consideration amount* from the original inventory has been subsumed into *current entry price*.

10. *Past exit price* was included as part of *allocated past price* in an intermediate version of the inventory used for the roundtables. The staff thought that it was appropriate to cover the practice of representing an asset in the financial statements using a modified (allocated) past entry price and subsequently remeasuring the asset at a current (exit) price, which becomes a past exit price and is itself depreciated. In some jurisdictions, for example, a headquarters building initially may be recorded at its entry price, which is then periodically reduced through depreciation allocations. Five years after its purchase, the building account may be adjusted upward to reflect its current exit price, and that amount is subsequently depreciated. The staff now views that practice as an example of a convention that combines more than one measurement basis. The staff also thinks that *past exit price* may have a place in decision making (in comparing an asset's exit price at two points in time, for example). Therefore, the staff segregated *past exit price* and gave it the status of a primary basis.

11. *Future entry price* was overlooked in the original inventory, perhaps because the staff did not find it represented in practice. However, the staff thinks it is used in decision making and therefore should be included in the revised inventory.

12. *Current entry price* (without related costs) was implied in the original inventory, as part of each of the variants now identified under 4.b.i. through 4.b.iv. However, the staff now thinks that those variants have traditionally assumed the inclusion of related costs. Therefore, 4.a., *current entry price* without related costs, has been added, and *current consideration amount* (for liabilities) has been subsumed in that variant.

13. Finally, *deprival value* and *relief value* have been deleted in the revised inventory. In the staff's view, neither of those measurement basis candidates is actually a single basis, but rather a decision rule for selecting among a group of measurement bases. In reviewing the literature on those concepts, the staff discovered authors who share that view, even among supporters of the concepts.

14. For the benefit of supporters of deprival value and relief value, the staff notes that the components of both concepts are found in the revised measurement basis inventory in the form of *current entry price* (with related costs), *current exit price* (with related costs), and *value in use.*[3]

15. Between the April 2006 joint meeting, in which the Boards approved the initial plan for the measurement phase, and the January/February 2007 roundtables, various Board members and constituents have proposed measurement basis candidates that were not included in either the original or revised inventory, such as lower-of-cost-or-market (used for inventory and some marketable securities) and initial fair value with subsequent proportional amortization (sometimes used for financial asset servicing assets and liabilities). In each case, the staff has concluded that the suggested candidates were either detailed rules or conventions constructed using one of the staff's proposed bases, or a convention that combined the use of more than one of the proposed bases. The staff thinks that the revised inventory is more than sufficient to enable the Boards to proceed to Milestone II of the measurement phase.

16. *Question: Do the Boards approve the staff's revised inventory of measurement basis candidates?*

ISSUE M02: ***How are the measurement bases defined?***

17. As a result of the changes made in the inventory of measurement basis candidates, the staff has altered the definitions of the bases as well. In doing so, the staff has tried to simplify the definitions and conform terms and word choices from one definition to another as much as possible.

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[3] *Deprival value* is commonly defined as the lower of replacement cost and recoverable amount, with recoverable amount being the higher of value in use and net selling price. Replacement cost is used as a synonym for current entry price (with related costs) and net selling price is used as a synonym for current exit price (with related costs).

Relief value is defined as the higher of consideration amount and settlement amount, with settlement amount being the lower of cost of performance and cost of release. Consideration amount is used as a synonym for current entry price (with related costs). Cost of performance and cost of release may be viewed as synonyms for current exit price (with related costs) in two different situations, namely (1) settlement by performance of the terms of a liability contract and (2) settlement by negotiating release from a liability contract.

18. Sufficient changes have been made in both the inventory and the definitions that the staff has created a new table that includes the revised measurement basis terms, their definitions, and current synonyms for the terms. That table is found in Appendix C.

19. *Question: Do the Boards approve the definitions of the measurement basis candidates***?**

ISSUE M03: ***What are the basic properties of the measurement bases?***

Issue M03a: ***How does each basis relate to prices and values, the building blocks of economic decisions?***

20. At the October 2006 joint meeting of the Boards, the staff presented a paper on prices and values that emphasized the importance of those concepts in the economic foundations of accounting and suggested that they play a role in classifying and understanding the inventory of measurement basis candidates. At that time, the staff provided a table which, in part, classified each basis as to whether it was a price, a value, or neither. The Boards were generally supportive of the staff's paper. Roundtable participants saw only the table, but seemed to have no difficulty with the staff's classification notion, as evidenced by the lack of negative comment on the issue.

21. Now that the inventory has been simplified by grouping all the bases into nine primary bases, all but one of which contains either the term *price* or the term *value*, the staff sees no further need for a classification table. The relationship of the primary bases to the concepts of price and value can be summarized by saying that seven of the nine (past, current, and future entry and exit prices, plus current equilibrium price) are prices, one (value in use) is a value, and the remaining one (modified past entry amount) is neither.

22. The staff acknowledges that its classification of bases into prices and values is very simple and, now that the inventory itself has been simplified and relabelled, perhaps obvious. Nevertheless, the staff thinks that the distinction between prices, values, and things that are neither will be helpful as the Boards and staff proceed to evaluating the measurement basis candidates in Milestone II.

23. The staff also acknowledges that while seven of the primary bases are classified as prices, those prices are not identical in all their properties. In the October paper, for example, the

staff contrasted the objectivity of transacted prices with the subjectivity of values. But not all prices are transacted and, thus, objective. The concept of a current equilibrium price as defined in the staff's measurement basis inventory is of something hypothetical, as the market conditions described in its definition do not exist. Furthermore, many future entry and exit prices are forecasts, and are therefore as subjective as values. This distinction among prices, and perhaps others, will undoubtedly play a part in the evaluation process to come. For now, the staff is satisfied that the simple classification of prices and values given above is sufficient for the Boards and staff to proceed to Milestone II.

24. *Question: Do the Boards approve the staff's price/value classification of measurement basis candidates?*

Issue M03b: ***What is the basic time orientation of each measurement basis?***

25. At both the October joint meeting and the measurement roundtables, the staff received numerous comments to the effect that its discussion of time orientation, including an accompanying table, was confusing and/ or unnecessary.

26. After reviewing its prior work on this issue, the staff thinks that it tried to infuse too much meaning into one idea and, as a result, confused different aspects of time in relation to the measurement basis candidates. Those aspects are:

    a. *The time frame a particular basis might represent in a financial statement or report.* For example, a *past entry price* might be used to represent an asset or liability in either a present or past balance sheet. Or, a *future exit price* might be used to represent an asset or liability in either a present or pro forma balance sheet.

    b. *The time frame to which the inputs to a particular basis refer.* Most of the primary bases in the revised inventory have either a single input or multiple inputs that refer to the same time frame. For example, the *past entry price* variant without related costs has a single input (an exchange price) that refers to a single time frame (the past), and the *past entry price* variant with related costs has multiple inputs (an exchange price for the asset and exchange prices for acquisition-related goods and services) that likewise refer to a single time frame (the past).

In contrast, both *modified past entry amount* and *value in use* rely on multiple inputs that may not refer to the same time frame. For example, the amortized variant of *modified past entry amount* has one input that refers to the past (an exchange price) and one or more that refer to the future (a forecast useful life and a forecast salvage value). Similarly, *value in use* may combine forecast cash flows that refer to many different time periods in the future with a discount rate that attempts to convert those forecasts to a present time frame.

c. *The time frame about which a particular basis provides information.* For example, a *past entry price* provides information about the past, while a *value in use* provides information about the present. This is the aspect of the relationship between the measurement basis candidates and time frame that is reflected in Appendices B and C, where the primary bases and their variants are sorted into past, present, and future categories. This aspect is also reflected in the names given to the primary bases (for example, ***past*** *entry price,* ***current*** *equilibrium price,* ***future*** *exit price),* with the exception of *value in use*. In the case of the latter, the staff considered using the terms *present value in use* or *current value in use*, but found the connotations of the adjectives *present* and *current* to be too similar to their uses in other accounting contexts.

27. The staff thinks that all three of the above time aspects are important and will need to be considered at some point in the process of evaluating the measurement basis candidates in Milestone II. However, the staff also thinks that the third aspect (¶27c above), the simplest and most basic, is useful and sufficient for classifying the bases in Milestone I. Therefore, the staff has eliminated from this paper the time frame orientation table provided in October and proposes to use the time frame classification as found in Appendices B and C.

28. *Question: Do the Boards accept the simplified time-frame classification?*

ISSUE M04: ***Are the measurement bases appropriate for both assets and liabilities?***

29. This issue was not considered at the joint meeting of the Boards in October. At the measurement roundtables, participants expressed two views related to this issue. One view

was that assets and liabilities should be treated the same with respect to measurement. The other view was that the valuation of liabilities is more difficult than that of assets. The staff thinks that those views could be interpreted (a) to support different bases for assets and liabilities, (b) to support the same bases for both while acknowledging that the bases might be more difficult to apply to liabilities than assets, or (c) as neutral with respect to the issue. As a result, the staff has not relied heavily on those views.

30. The staff notes that some of the measurement basis variants are based on concepts that apply only to assets. Those variants, all of *current entry price* with related costs (namely identical replacement, identical reproduction, equivalent replacement, and productive capacity replacement), are clearly identified in Appendix C as applying only to assets.

31. With the above exception, the only differences between asset and liability measurement bases that the staff discovered while compiling its original inventory related to language, not concepts. [Sentence omitted from observer notes]

32. In its original inventory, the staff retained some measurement basis terms that were applied only to assets or liabilities based on language (current consideration amount, deprival value, and relief value). In the revised inventory, such terms have been eliminated. The staff thinks that both the concepts and the language of the nine primary measurement basis candidates are sufficient to address the needs of both assets and liabilities. Within the definitions of the measurement bases, however, the staff has retained some differential language to satisfy custom and tradition. For example, assets are *purchased* or *sold* in the definitions while liabilities are *incurred* or *eliminated*. The staff does not think that such differences in the definitions affect the suitability of the primary measurement basis candidates for use with both assets and liabilities.

33. *Question: Do the Boards accept the revised measurement basis inventory as appropriate for both assets and liabilities (with the exception for certain current entry price variants noted above)?*

ISSUE M05: *Are there any measurement basis candidates that should be eliminated from consideration for evaluation in Milestone II?*

34. This issue is the second of two that were not considered in the October joint meeting of the Boards. At the measurement roundtables, a few participants voiced the opinion that it should be possible to eliminate a few measurement basis candidates, but no one made particular suggestions.

35. In paragraphs 13 and 14 above, the staff discussed the proposed elimination of *deprival value* and *relief value* as measurement basis candidates in its revised inventory. Beyond that proposal, the staff does not favour further reduction of the inventory.

36. As mentioned earlier, the staff thinks that most of the analysis in the Milestone II evaluation of measurement basis candidates can be done at the level of the nine primary bases, with occasional reference to variants. However infrequent as analysis at the variant level might be, that analysis could well provide insights helpful to understanding the analysis at the primary basis level. It is also possible that a particular variant may differ in some way from other variants of the same primary basis, such that an evaluation of that variant will result in a different outcome than the evaluation of the other variants. Those reasons underlie the staff's position on this issue.

37. *Question: Do the Boards approve proceeding to Milestone II without further reduction of the measurement basis inventory?*