



**International  
Accounting Standards  
Board**

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*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

### **INFORMATION FOR OBSERVERS**

**Board Meeting:** January 2009, London

**Project:** Conceptual Framework – Measurement (phase C)

**Subject:** Narrowing the Set of Measurement Bases for the Framework and Consequences for Viewing Measurement Issues (Agenda paper 4)

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### **PURPOSE OF THIS MEMO**

1. The previous memorandum on measurement discussed five factors that could be considered in deciding whether to measure an asset or liability using a current value or a non-current value. Both Boards generally agreed to the content and direction of that memorandum. The purpose of this memo is to continue developing an approach to selecting from among measurement bases at a high level rather than working on a detailed analysis of when current values should be used and when non-current values should be used.
2. This memorandum addresses two questions:
  - a. Can the number of measurement bases that might be used in the framework be reduced before discussing the choice between current and non-current values in more detail?

- b. Assuming that a choice of measurement basis is from among current values or from among non-current values (rather than between a current value and a non-current value), what aspects of the remaining measurement bases need to be considered to develop conceptual guidance for an improved mixed-basis measurement system?
3. The staff thinks that answering those questions may simplify both the choice between using a current or a non-current measurement basis and the selection of a particular measurement basis from among current or non-current bases. In this memorandum, we address those questions interactively, then summarize our recommendations and present our take on the consequences of our recommendations for viewing remaining measurement issues.
4. We think that the result of our recommendations would be a blueprint for a mixed-basis measurement system that would closely resemble the present system but would be simpler and more rational.

#### **RECASTING THE SET OF POTENTIAL MEASUREMENT BASES**

5. It has been some time since the Boards discussed the set of measurement bases tentatively agreed to in 2007. Those bases were divided into three groups, according to past, present, or future time orientations. During November meetings, some Board members questioned whether those groupings would be helpful, and one Board member noted that for a basis to be considered a measurement (as opposed to a non-measurement quantification) it would have to be either a past price or an estimated price.
6. As a result of those comments, the staff has recast the set of potential measurement bases for the framework into two groups, as follows:
  - a. *Actual, estimated, and forecast prices.* This group includes actual and estimated past entry prices, estimated past exit price, actual and estimated current entry prices, estimated current exit price, and forecasts of future entry and exit prices. Those prices are before any transaction costs or other adjustments. Entry prices may be actual or estimated, depending on whether a transaction price is used or an estimate is made of what an entry price would be in the absence of a transaction price. Exit prices are all estimates, because actual exit prices are available only when assets are

- disposed of or liabilities are extinguished, in which case those items are no longer reported.
- b. Additional bases may be created from the above prices by considering transaction costs or by making other adjustments, such as allocations and valuation allowances. Any of the unadjusted prices could be based on actual or hypothetical exchanges of either individual assets or liabilities or groups of identical or similar assets or liabilities that might be transferred together at a price different from the sum of the individual prices. Price bases and possible adjustments to them are summarized in Table 1 on page 4.
  - c. *Non-price amounts.* This group includes value in use, prescribed present value computations, and fair-value-based amounts. Prescribed present value computations and fair-value-based amounts could be used either for individual assets or liabilities or for groups of identical or similar assets or liabilities that might be transferred together at a price different from the sum of the individual prices. Value in use, however, may be suitable only for groups of assets or liabilities. This group of bases is summarized in Table 2 on page 5.

**Table 1: Actual, Estimated, and Forecast Prices**

<b>Possible prices</b>	<b>Possible adjustments</b>	<b>Comments</b>
Actual or estimated past entry price (including accumulation of prices and costs of constructed assets)	a. Actual transaction costs b. Systematic increase or decrease to a terminal value c. Valuation allowances for impairment	Similar to historic cost or historical cost (or proceeds) except that those amounts may include transaction costs
Estimated past exit price	a. Actual transaction costs b. Systematic increase or decrease to a terminal value c. Valuation allowances for impairment	Used for some impairments
Actual or estimated current market entry price	Actual or estimated transaction costs	Sometimes used as a surrogate for exit price and possibly instead of exit price under IFRS or GAAP prior to Statement 157
Estimated current market exit price	a. Estimated transaction costs b. Prepayment penalty c. Early withdrawal penalty d. 'Fire sale' discount e. Costs to complete or otherwise prepare for sale	Fair value computed under the 'in exchange premise' as defined in Statement 157
Forecast future entry price	Estimated transaction costs	Not currently used except as an input to value in use estimations
Forecast future exit price	a. Estimated transaction costs b. Prepayment penalty c. Early withdrawal penalty d. 'Fire sale' discount e. Costs to complete or otherwise prepare for sale	Basis for recognizing contingent losses under Statement 5

**Table 2: Non-price Amounts**

<b>Possible nonprice amounts</b>	<b>Description</b>	<b>Comments</b>
Value in use	Probability weighted future cash flows to be generated by using (not selling) an asset discounted to current date	This would not seem to apply to liabilities. Cash flows could be market based or entity specific. If market based, it would seem to be the fair value in Statement 157 determined under the “in use premise.”
Prescribed present value computation	Probability weighted or most likely future cash flows discounted at a specified rate	One of the options for impaired loans under Statement 114
Fair-value-based amounts	A form of prescribed present value. It starts with a fair value computation similar to that of Concepts Statement 7, but omits one or more factors that market participants would consider.	Used in Statement 123R. Fair value without changes in credit risk would be in this category

**REDUCING THE NUMBER OF POTENTIAL MEASUREMENT BASES**

- Reducing the number of measurement bases to choose from in the conceptual framework is one way to simplify, and thus improve, the current mixed-basis measurement system. The following paragraphs include the staff’s recommendations in this regard.

**Actual, Estimated, and Forecast Prices**

**Past prices not actually used as measurements**

- Actual or estimated past entry price has been included in Table 1 because many of the quantifications presently used for assets and liabilities (and referred to as historical costs) are derived by adjusting a past entry price. However, past entry prices are not really used to either measure or quantify either assets or liabilities at initial recognition, nor are they

used to remeasure or requantify. When an unadjusted past entry price appears in financial statements, it is because an actual or estimated current entry price has been used to measure an asset or liability at initial recognition but the asset or liability has not been remeasured or otherwise requantified at subsequent reporting dates. The reporting treatment of unimproved land is an example.

9. Similarly, past estimated exit prices are not really used to measure assets and liabilities. Rather, an estimated current exit price is sometimes used as a measure in impairment situations, then left unadjusted or adjusted by allocation or some other mechanism at subsequent reporting dates. The reporting of impaired inventory is an example of that treatment.
10. Because neither past entry prices nor past exit prices are used to measure assets and liabilities and there is no apparent reason that they should be so used, we think those prices should be eliminated as measurement bases in the conceptual framework. At the same time, the framework could acknowledge that assets and liabilities are sometimes reported at past prices if they are not remeasured or otherwise requantified. The framework could also state that eliminating past entry and exit prices as measurement bases would not preclude the use of measurement bases derived from adjustments to those prices.

### **Eliminate future prices as measurement bases**

11. The staff recommends eliminating forecast future entry price as a measurement basis on two grounds. The first is that using a forecast future price to represent a present asset or liability is inconsistent with the asset and liability definitions being developed in Phase B of the conceptual framework project. Except by chance, a forecast future price cannot faithfully represent assets or liabilities in their current states.
12. The second reason for eliminating forecast future entry price is that it does not appear to be used independently as a measurement basis in practice. Forecast future entry prices may be used as inputs to value in use estimations, but that use does not qualify future entry price as a separate measurement basis. For example, the estimation of the value in use of an asset with multiple components with varying useful lives or of a cash generating business unit comprising many assets with different lives may require an assumption that one or more of

the components or assets be replaced before the disposal of the entire asset or business unit. Eliminating forecast future entry price as an independent measurement basis would not preclude that use in conjunction with value in use.

13. The staff also recommends eliminating forecast future exit price as a measurement basis. Using forecast future exit prices to represent present assets and liabilities is also inconsistent with the developing asset and liability definitions and faithful representation, although such forecasts are sometimes used in practice to quantify so-called contingent liabilities under FAS 5. For example, an entity may record a forecast of a future lawsuit settlement as a present liability even though no present obligation exists with respect to the lawsuit.
14. Forecast future exit prices are also adjusted to create estimates of adjusted current exit prices. For example, net realizable values (which we think are equivalent to estimated current exit prices less transaction costs or, in some cases, costs to complete) may be estimated by starting with a forecast future exit price rather than an estimated current exit price. Eliminating forecast future exit price as an independent measurement basis would not preclude its use in estimating current exit prices.

## **Non-price Amounts**

### **Eliminate value in use as a measurement basis**

15. Value in use is sometimes cited as a good measurement basis for groups of assets that generate cash flows as a unit when current value information about those assets is relevant. That is particularly the case when obtaining current values for the individual assets in a group is difficult or costly.
16. However, value in use has some important disadvantages. One is that it is highly subjective or entity-specific. On the one hand, forecasts of the future cash flows that the particular entity will be able to generate using a group of assets can be overly optimistic and result in overvaluing the asset group relative to a market assessment of value. On the other hand, a particular entity may decide to use a group of assets in a suboptimal manner

for various reasons, resulting in an undervaluation of the asset group relative to a market assessment.

17. A second disadvantage of value in use is that it incorporates the present value of future profits into the reported amounts of assets before those profits have been earned. Theoretically, it should be possible to adjust the value in use of assets each reporting period so that profits recognized in the statement of comprehensive income are not duplicated in the statement of financial position. However, it would still be difficult for financial statement users to compare asset values based on value in use with those based on some other current value unless the future profits portion of each reported value in use amount were disclosed.
18. Considering both its advantages and disadvantages, the staff recommends excluding value in use from the conceptual framework. We think that the in-use valuation notion in fair value (which we classify with the estimated current exit price basis) better satisfies the need for a measurement basis that can be used for a group of assets that generate cash flows together. Because fair value takes a current market perspective, an estimate of in-use fair value avoids the subjectivity and capitalization of future profits associated with value in use. Furthermore, in-use fair value estimates can be made for individual assets, something that is difficult to do with value in use.

#### **CONSIDERING REMAINING MEASUREMENT BASES**

19. If the staff initial recommendations are followed, the measurement bases that would remain include:
  - a. Adjusted past entry price
  - b. Adjusted estimated past exit price
  - c. Actual or estimated current entry price
  - d. Estimated current exit price
  - e. Prescribed present value computation



- f. Fair value-based amount.
20. The paragraphs that follow in this section discuss aspects of the remaining measurement bases that the Boards may wish to consider as the measurement chapter of the framework is developed. Those considerations could result in a further narrowing of the set of measurement bases or in simplifications or other changes that might improve a mixed-basis measurement system.
21. We acknowledge that the recommendations for consideration in this section are not necessarily supported by all of the analysis that the Boards might need to reach decisions. We will present further analysis at future meetings for any of the points that the Boards are interested in considering.

#### **Adjusted Actual or Estimated Past Entry Price and Adjusted Estimated Past Exit Price**

22. Currently, adjustments made to past prices produce a variety of adjusted amounts. We have identified two aspects of the use of adjusted past prices that the Boards might want to reconsider in the context of improving the current mixed-basis measurement system. Those are:
- a. Defaulting to adjusted past prices when current prices are not used for remeasurement
  - b. Adjusting current-value impairments.

As we discuss the above adjustments, keep in mind that an unadjusted past entry or exit price that is carried over to a subsequent reporting period is not a current measurement. Furthermore, adjusting a past price does not make the resulting amount a measurement, either.

#### **Reconsider defaulting to adjusted past prices when current prices are not used**

23. The current mixed-basis system seems to operate on the assumption that if remeasuring an asset or liability at a current price is not possible or is otherwise not considered appropriate, then an adjusted past price should be used. We can understand that assumption, given the

24. To illustrate our point, we use the example of the depreciated book value of plant and equipment. A majority of Board members and constituents seem to agree that as a general rule the current value of plant assets is not highly relevant to financial statement users. The accepted default is to allocate the actual past entry prices of those assets to accounting periods using accounting depreciation. However, it is not clear that either depreciated book values of plant assets or accounting depreciation expense are useful either. In fact, analysts regularly back out depreciation expense in performing their analyses. Why then, should such an adjusted past entry price be the default for quantifying plant assets?
25. We think that for some assets and liabilities, such as plant assets, there are better alternatives to using adjusted past prices, including:
- a. *Leaving past entry prices unadjusted.* Actual past entry prices would not appear to provide information that is less useful than their adjusted counterparts and are certainly less costly to provide. Those past prices could be reported as originally recognized in the financial statements, or they could be indexed for general purchasing power changes so that all actual past entry prices would be reported in constant currency units. One consequence of not adjusting the past entry prices of plant assets that tend to decline in value over time, or of indexing those prices for purchasing power changes, would be larger write-offs, and thus losses, at the time of disposal of those assets. On the other hand, gains on the disposal of real estate, which tends to increase in value over time, would be smaller.
  - b. *Using adjusted past entry prices as estimates of current prices.* With little added effort, many past prices could be adjusted to estimate current prices. For example, real estate used in manufacturing activities could be indexed using regional or national real estate price indices to estimate a current price. Plant assets that tend to decline in value over time could be depreciated more carefully than is now done, so that depreciated book values approximated current prices. Although those estimated current prices might not be considered highly relevant to most users, they could be

## **Reconsider adjusting current-value impairments**

26. By current-value impairment, we mean a write-down of an asset from its actual past entry price or adjusted actual past entry price to a current value of some kind. Not all impairments are current-value impairments, but many are. For those assets that are written down to current value, the subsequent accounting treatment varies. Some assets remain at the current value to which they were written down. However, other assets, notably depreciable assets, continue to be depreciated using the current value as the new depreciation base.
27. That mixing of remeasurement at an estimated current exit price (or adjusted estimated current exit price in the case of net realizable values) with adjustments typically made to actual past entry prices gives rise to adjusted past estimated exit prices and is an odd marriage of the historical cost matching system and the current valuation system of quantifying assets and liabilities.
28. We think that the mixed-basis measurement system could be simplified by eliminating adjusted past estimated exit price as a basis if current-value impairments were divorced from adjustments normally made to actual past entry prices. If current-value impairments were thought of as remeasurements toward current value instead of an adjustment to historical cost, then it would make more sense to adopt one of the alternatives similar to those in paragraph 25 than to make, say, accounting depreciation adjustments to the current-value impairment amount. That is, it might be preferable to either leave current-value impairments unadjusted at subsequent reporting dates or to use any subsequent adjustments more thoughtfully to estimate current prices.

## **Actual or Estimated Current Entry Price and Estimated Current Exit Price**

29. The question we pose regarding actual or estimated current entry price and estimated current exit price is whether all of those prices should be choices in the framework for both initial recognition and remeasurement.

### **Consider limiting measurement at initial recognition to current entry price**

30. There is a general attraction to using actual current entry price for initial recognition because it is the concrete transaction price that forms the basis for so much of our present accounting system. When a price transaction is lacking at initial recognition, estimated current entry price naturally appears to be the next best alternative (although that conclusion may change when we later consider liabilities more carefully, especially uncertain liabilities).
31. In contrast, there is a general aversion to using estimated current exit price at initial recognition whenever it differs from current entry price. That aversion seems to be rooted in the fact that in such cases, estimated current exit value is at odds with the concrete transaction price as well as the fact that in some circumstances a gain or loss would be recognized.
32. In light of the above attitudes, the Boards may want to consider restricting the use of measurement bases at initial recognition to either actual or estimated current entry price, as the situation dictates. That practical expedient would simplify measurement at initial recognition and allow the Boards to focus on the more difficult question of remeasurement.

### **Consider limiting remeasurement to current exit price**

33. After initial recognition of an asset or liability, actual current entry prices are no longer particularly relevant. Assuming that value in use is not retained in the framework, the choice among current values is then one between estimated current entry price and estimated current exit price.
34. The potentially differing treatment of those two current prices by the Boards leads us to another consideration. The FASB has defined fair value in terms of exit price, but the

IASB, in its fair value project, has tentatively concluded that there is no difference between entry price and exit price when fair value is determined in the same market. Therefore, the Boards may wish to consider whether estimated current exit price should be the only measurement basis used to remeasure assets and liabilities at a current price. That choice would simplify remeasurement, just as initial recognition would be simplified by using only actual or estimated current entry price.

### **Prescribed Present Value Computation and Fair-value-based Amounts**

35. As noted in Table 2, what we have described as a fair-value-based amount is actually a subset of prescribed present value computations. Both prescribed present value computations and fair-value-based amounts may be regarded as non-price amounts that mimic fair value to some extent but fall short of it for one reason or another.
36. Prescribed present value computations other than fair-value based amounts contain all the elements of an estimation of fair value that is constructed from the ground up, but they dictate one or more of those elements in such a way that the end result is not an estimate of fair value. For example, FAS 123R requires a nonpublic entity to calculate a value for its equity share options using the historical volatility of an industry sector index rather than the expected volatility of the entity's share price when it is not practicable to estimate the expected volatility. In that case, share price volatility is considered in the value calculation, but not in a way that produces a fair value estimate.
37. Fair-value-based amounts, on the other hand, exclude one or more elements of a complete fair value estimation, although they do not dictate how to obtain the elements that are included in the computation.
38. There are two questions for the Boards to consider with respect to the above non-price amounts:
  - a. Should any amounts that are not actual prices, estimates of prices, or derived from actual or estimated prices be included as measurement bases in the framework?
  - b. If so, are both prescribed present value computations and fair-value-based amounts needed?

39. The answer to 38(a) depends in part on the Boards' understanding of settlement value for liabilities. We think that some notion of current settlement value for liabilities is needed in the framework. We also think that the notion of current settlement value is encompassed by estimated current exit price.
40. However, fair value as described by the FASB does not include settlement value. If the Boards agree that current settlement value is an estimated current exit price notion, then we recommend excluding non-price amounts from the framework. There are potentially an infinite variety of non-price amounts that could be constructed. We think that the resulting mixed-basis measurement system would be more coherent and much simpler if non-price amounts were excluded.
41. On the other hand, if the Boards conclude that current settlement value is not a current exit price notion, then we would recommend excluding non-price amounts for assets but including them on a limited basis for liabilities.

## **SUMMARY**

42. Our recommendations are summarized in the paragraphs that follow.
43. The measurement bases that we recommend including in the framework are:
  - a. Adjusted past entry price
  - b. Actual or estimated current entry price
  - c. Estimated current exit price.
44. Under our recommendation, actual or estimated past entry prices would also appear in financial statements as a result of initially recognizing assets or liabilities at current entry prices but not subsequently adjusting or remeasuring those initial prices.
45. Although the initial entry prices of some assets and liabilities would be adjusted using various accounting conventions instead of being remeasured at a current value, initial prices for so-called fixed assets or plant assets would either be left unadjusted, adjusted for general price-level changes, or remeasured at a current value.

46. Asset impairments would be treated as current value remeasurements made to past entry prices when some current value indicator falls below an asset's past or adjusted past entry price. Impairment remeasurements would not be adjusted subsequently through allocations or other adjustments typically made to past entry prices. Whether impaired assets would be remeasured at current value in subsequent periods would be a standards-level decision.
47. At initial recognition, only actual or estimated current entry prices would be used as measurement bases.
48. For remeasurement, only estimated current exit price would be used (remeasurement would not include conventional accounting adjustments).

### **CONSEQUENCES FOR VIEWING REMAINING MEASUREMENT ISSUES**

49. If our recommendations are followed, measurement at initial recognition becomes a non-issue from the perspective of selecting a measurement basis. An actual current entry price would be used whenever possible. Otherwise, a current entry price would be estimated.
50. Subsequently, the measurement issue would be whether to remeasure. If remeasurement were chosen, the measurement basis would be estimated current exit price (assuming current settlement value is accepted as a current exit price notion). If remeasurement were rejected, a choice would remain among:
  - a. Leaving the asset or liability's past entry price unadjusted
  - b. Adjusting the past entry price using a conventional accounting adjustment (other than accounting depreciation)
  - c. Adjusting the past entry price for changes in the general price level.
51. We plan to return to the Boards next with a broad scheme for making the choice between remeasuring at current value and not remeasuring.