

STAFF PAPER

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Project	Conceptual Framework
Paper topic	Measurement – Objective and the effect of the qualitative characteristics
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Purpose of paper

1. The purpose of this paper is to discuss:
 - (a) the objective of measurement; and
 - (b) the implications of the qualitative characteristics of useful financial information for measurement.
2. This paper does not address:
 - (a) different measurement bases and their characteristics (See AP 10K *Measurement – Measurement categories* and AP 10L *Measurement – Cash-flow-based measurements*);
 - (b) the selection of a measurement basis. This will be addressed at a future meeting.

Summary of staff recommendations

3. The staff recommend that the Exposure Draft should:
 - (a) **not** define a separate measurement objective.
 - (b) describe as follows how measurement contributes to the overall objective of financial reporting:

Measurement provides information in monetary terms about the resources of an entity, claims against the entity and changes in those resources and claims. Such information helps users to assess the entity's prospects for future cash flows and assess management's stewardship of the entity's resources.

- (c) state that when the IASB selects a measurement, it should consider the nature and relevance of the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI).
- (d) state that:
 - (i) the level of uncertainty associated with the measurement of an item (the reliability of that measurement) is one of the factors that should be considered when selecting a measurement basis; and
 - (ii) a high degree of measurement uncertainty should not prevent the use of a measurement basis that provides relevant information.
- (e) refer explicitly to reliability when describing the level of measurement uncertainty associated with the measurement of an item.
- (f) retain the discussion of faithful representation included in the Discussion Paper.
- (g) discuss in the measurement section the idea that a faithful representation by itself does not necessarily result in useful information. The information provided by the representation must also be relevant.
- (h) explain the need to weigh the benefits of a new or different measurement basis against any increased costs or complexity. This would replace the statement in the Discussion Paper that the number of measurement bases should be the smallest necessary to provide relevant information.
- (i) retain a discussion of necessary and unnecessary changes in measurement bases.

- (j) include the discussion of the other enhancing qualitative characteristics suggested in the Discussion Paper, largely unchanged.
- (k) retain a separate reference to the cost-benefit constraint as one of the factors the IASB should consider when selecting a measurement.

Structure of paper

4. This paper is structured as follows:
- (a) Objective of measurement (paragraphs 5-13);
 - (b) Implications of the qualitative characteristics on measurement
 - (i) Relevance (paragraphs 14-23)
 - (ii) Faithful representation (paragraphs 24-29)
 - (iii) Understandability (paragraphs 30-39)
 - (iv) Other enhancing qualitative characteristics (paragraphs 40-42)
 - (v) Cost-benefit constraint (paragraphs 43-45).

Objective of measurement

Background

5. The Discussion Paper suggested that the objective of measurement is to contribute to the faithful representation of relevant information about:
- (a) the resources of the entity, claims against the entity and changes in resources and claims; and
 - (b) how efficiently and effectively the entity's management and governing body have discharged their responsibilities to use the entity's resources.

Summary of feedback

6. Most of those who responded to this question stated that they agreed with the suggested objective of measurement.

7. A few welcomed the clear link from the suggested objective of measurement to the objective of financial reporting and the qualitative characteristics of useful financial information.
8. However, some disagreed with the suggested measurement objective. Most of them stated that it simply repeats the objective of financial reporting and the qualitative characteristics of useful information and, consequently, would be unlikely to provide useful guidance to the IASB in setting measurement requirements. A few respondents suggested that, instead of including a measurement objective, the *Conceptual Framework* should describe how measurement contributes to the overall objective of financial reporting. For example, one respondent suggested that:
- ...the objective of measurement is to quantify in monetary terms the elements of financial statements so as to enable financial statements to satisfy the chosen objective(s) of general purpose financial reporting. *Carien van Mourik*
9. A few respondents suggested that the two components of the measurement objective (to provide information about resources and claims and information about how management have discharged their responsibilities) might lead to different conclusions about the most appropriate measurement basis and that the *Conceptual Framework* should therefore explain how to balance these components.
10. In addition, a few respondents suggested:
- (a) separate measurement objectives for the statement of financial position, profit or loss and OCI;
 - (b) separate measurement objectives for particular types of assets and liabilities;
 - (c) replacing the reference to faithful representation in the suggested objective with a reference to reliability;
 - (d) referring to the information needed to help users assess the prospects for future cash flows to the entity.

Staff analysis and recommendation

11. The staff agree with those respondents who stated that the proposed measurement objective simply repeats the objective of financial reporting and the qualitative characteristics of useful information and, consequently, is unlikely to provide useful additional guidance to the IASB in setting measurement requirements. Although the guidance on measurement in the Discussion Paper discusses the implications of relevance, faithful representation and the enhancing qualitative characteristics for measurement, it does not refer back to the measurement objective.
12. The staff believe it is important to provide a link between measurement and the overall objective of financial reporting. However, we believe that this can be achieved by describing how measurement contributes to the overall objective of financial reporting rather than by defining a separate measurement objective.
13. We therefore recommend that the *Conceptual Framework* should state that:

Measurement provides information in monetary terms about the resources of an entity, claims against the entity and changes in those resources and claims. Such information helps users to assess the entity's prospects for future cash flows and assess management's stewardship of the entity's resources.

Question 1

The staff recommend that the Exposure Draft should:

- (a) **not** define a separate measurement objective; and
- (b) describe how measurement contributes to the overall objective of financial reporting as outlined in paragraph 13.

Do you agree?

Implications of the qualitative characteristics for measurement

Relevance

Background

14. The Discussion Paper suggested that:
- (a) A single measurement basis for all assets and liabilities may not provide the most relevant information to users of financial statements;
 - (b) The relevance of a particular measure will depend on how users of financial statements are likely to assess how an asset or a liability of that type will contribute to future cash flows. Consequently, the selection of a measurement:
 - (i) For a particular asset should depend on how that asset contributes to future cash flows; and
 - (ii) For a particular liability should depend on how the entity will settle or fulfil that liability.
 - (c) When selecting a measurement basis, the IASB should consider what information that measurement basis will produce in both the statement of financial position and the statement(s) of profit or loss and OCI. Selecting measurements by considering either the statement of financial position alone, or the statement(s) of profit or loss and OCI alone, will not usually produce the most relevant information for users of financial statements.
15. Agenda Paper 10K *Measurement – Measurement Categories* describes different measurement bases and the information that they provide. The selection of a measurement basis will be discussed at a future meeting. Consequently, this paper does not address the preliminary views summarised in paragraphs 14(a) & 14(b).
- Considering both the statement of financial position and the statement(s) of profit or loss and OCI*
16. Most respondents who commented on this question agreed that the IASB should consider both the statement of financial position and the statement(s) of profit or loss and OCI when selecting a measurement.

17. However, a few respondents stated that:
- (a) the IASB should give more weight to the effect a particular measurement would have on the statement(s) of profit or loss and OCI, rather than the statement of financial position, when selecting a measurement;
 - (b) if the IASB is to consider the effect of measurement on both the statement of financial position and the statement(s) of profit or loss and OCI when selecting a measurement, the *Conceptual Framework* will need to include more guidance on the objectives of those statements. Agenda paper 10F *Presentation and disclosure – Scope and content* discusses whether to include separate objectives for the statement of financial position and the statement(s) of profit or loss and OCI;
 - (c) the IASB should normally require the same measurement for both profit or loss and the statement of financial position (that is, there should be few cases when one measurement basis is used for the statement of profit or loss and a different measurement basis is used for the statement of financial position, with the difference in OCI). However, a few other respondents supported the use of different measurements for the statement of financial position and profit or loss in situations where more than one measure of an asset or liability was considered relevant. The use of different measurement bases for the statement of profit or loss and the statement of financial position and the consequential use of OCI was discussed by the IASB in June 2014.
18. In line with the responses to the Discussion Paper, the staff continue to believe that when the IASB selects a measurement, it should consider the nature and relevance of the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and OCI.
19. The staff believe that the relative weights that the IASB will need to give to the information produced in the statement of financial position and the statement(s) of profit or loss and OCI will depend on the circumstances. Consequently, the staff do not believe that the Exposure Draft should state that either statement should be given more weight than the other statement.

Question 2

The staff recommend that the Exposure Draft should state that when the IASB selects a measurement, it should consider the nature and relevance of the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and OCI.

Do you agree?

Other implication of relevance - reliability

20. Some respondents to the Discussion Paper suggested that one of the factors that should be considered in selecting a measurement basis is the reliability of different measurement bases (ie the degree of measurement uncertainty associated with a particular measurement).
21. At the May 2014 meeting, the IASB tentatively decided not to reintroduce reliability as a qualitative characteristic of useful financial information. However, as noted during that meeting, paragraph QC16¹ of the existing *Conceptual Framework* suggests that if the level of uncertainty in an estimate is very high then that estimate might not provide relevant information.
22. Consequently, the staff believe that the level of uncertainty associated with the measurement of an item (the reliability of that measurement) should be considered when assessing whether a particular measurement basis provides relevant information. However, it is only one of the factors that should be considered in that assessment. Sometimes a measurement with a high degree of uncertainty provides the only relevant information about an item. For example, this may be the case with many non-traded derivative financial instruments. Hence, a high degree of measurement uncertainty should not prevent the use of a measurement basis that provides relevant information.
23. In addition, the staff propose to refer explicitly to reliability in the *Conceptual Framework* when describing the level of measurement uncertainty associated with the measurement of an item.

¹ See appendix for the text of paragraph QC16

Question 3

The staff recommend that the Exposure Draft should:

- (a) state that the level of uncertainty associated with the measurement of an item (the reliability of that measurement) is one of the factors that should be considered when selecting a measurement basis.
- (b) state that a high degree of measurement uncertainty should not prevent the use of a measurement basis that provides relevant information.
- (c) refer explicitly to reliability when describing the level of measurement uncertainty associated with the measurement of an item.

Do you agree?

Faithful representation***Background***

24. The Discussion Paper suggested that the fundamental qualitative characteristic of faithful representation has fewer implications for measurement than relevance does. However, the Discussion Paper highlighted the following:
- (a) A faithful representation is free from error. However, this does not mean that measurements must be perfectly accurate in all respects. An estimate of an unobservable price can be faithfully represented if it is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained and no errors have been made in selecting and applying an appropriate process for developing the estimate².
 - (b) When deciding whether a particular measurement faithfully represents an entity's financial position and performance, the IASB may need to consider how best to portray any link between items. When assets and liabilities are related in some way, using different measurements for those assets and liabilities can create a measurement inconsistency

² See QC15 of the existing *Conceptual Framework*

(sometimes called an ‘accounting mismatch’). Measurement inconsistencies can result in financial statements that do not faithfully represent the reporting entity’s financial position and performance. This may be particularly likely when the cash flows from one item are contractually linked to the cash flows from another item.

Feedback

25. The Discussion Paper did not include a specific question on how the qualitative characteristic of faithful representation could affect measurement. Consequently, few respondents commented on this issue:
- (a) A few respondents disagreed with the idea that an estimate of an unobservable price can be a faithful representation if adequate disclosures are made. These respondents argued that an estimate of an unobservable price could be a faithful representation of that estimate. However, if the uncertainties associated with that estimate are too large, the estimate could not be a faithful representation of the item being depicted.
 - (b) One respondent stated that it is not possible to consider whether an item has been faithfully represented without first identifying the measurement objective for that item. For example, historic cost faithfully depicts the purchase price of an asset, fair value faithfully depicts the price for which the entity could sell the asset.
 - (c) One respondent stated that the suggestions in the Discussion Paper gave too much prominence to relevance and understated the importance of faithful representation.
 - (d) A few respondents stated that including the effect of changes in own credit in the remeasurement of liabilities may not result in a faithful representation if those effects are not expected to be realised.
 - (e) One respondent stated that hedge accounting may be required to ensure that the links between related items are faithfully represented.

Staff analysis and recommendation

26. The staff continue to believe that the discussion of faithful representation in the Discussion Paper (summarised in paragraph 24) is correct and, therefore, recommend that it is carried forward to the Exposure Draft.
27. We believe that the concerns summarised in paragraphs 25(a) & 25(b) could, in part, be addressed if the measurement section of the Exposure Draft reiterated the statement in paragraph QC 16 of the existing *Conceptual Framework* that a faithful representation by itself does not necessarily result in useful information. The information provided by the representation must also be relevant. For example:
- (a) the historic cost of a derivative might be capable of being faithfully represented but the information provided by that representation would not be useful if the information provided is not relevant.
 - (b) an estimate of an unobservable price may be capable of being faithfully represented but if the price of the item being represented is not relevant to the decisions made by users, that information will not be useful.
28. Whether the effects of changes in own credit should be included in the measurement or remeasurement of liabilities is discussed in AP 10L *Measurement – Cash-flow-based measurements*.
29. We do not recommend including a specific reference to hedge accounting in the *Conceptual Framework* because we believe that hedge accounting is more appropriately addressed at a standards-level. However, we believe that hedge accounting could be viewed as an application of the notion that a faithful representation may sometimes require a portrayal of the links between related items.

Question 4

The staff recommend that the Exposure Draft should:

- (a) carry forward the discussion of faithful representation summarised in paragraph 24;
- (b) discuss in the measurement section the idea that a faithful representation by itself does not necessarily result in useful information. The information provided by the representation must also be relevant.

Do you agree?

Understandability***Background***

30. The Discussion Paper suggested that the understandability of financial statements could be enhanced if:
- (a) The number of different measurement bases used is limited to the smallest number necessary to provide relevant information.
 - (b) Unnecessary changes in measurement bases are avoided and necessary changes are clearly explained. Consequently:
 - (i) subsequent measurements should be the same as, or at least consistent with, initial measurement. To do otherwise would result in recognising income or expense that does not depict transactions or changes in economic conditions.
 - (ii) optional changes in measurement bases should be avoided because otherwise entities could manage earnings by choosing to change the measurement basis used for a particular item.
31. The Discussion Paper went on to state that avoiding changes in measurement bases would not preclude:
- (a) adjustments to cost-based measurements to reflect, for example, impairments. Impairment adjustments result from economic changes,

rather than from changes in measurement bases and as such provide relevant information for users of financial statements;

- (b) changing measurement requirements to improve the relevance of the information presented.

Feedback

- 32. Many of those who commented agreed with the IASB’s preliminary view that the number of measurement bases used should be the smallest number necessary to provide relevant information. The main reasons cited were that limiting the number of measurement bases would increase the comparability and understandability of the financial statements.
- 33. However, some respondents disagreed with this preliminary view stating that there should not be an artificial limit on the number of measurement bases used. A different measurement basis should be used if the IASB believes it will provide relevant information to the users of financial statements.
- 34. Some respondents noted that if the IASB adopted a single measurement basis for all assets and liabilities, the need to minimise the number of measurement bases used would not arise.
- 35. Few respondents commented on the suggestion that unnecessary changes in measurement bases should be avoided. However, those that did comment agreed with this suggestion.

Staff analysis and recommendation

- 36. The staff believe that it was not the IASB’s intention to impose an artificial limit on the number of measurement bases used when developing Standards. We agree that a different measurement basis should be used if it would provide relevant information to users of financial statements.
- 37. However, there are problems associated with requiring the use of new or different measurement bases:
 - (a) Requiring a new or different measurement basis increases the complexity of the financial statements and hence could decrease their understandability. In general, the greater the number of measurement

bases used in a set of financial statements the greater the complexity of the resulting information.

- (b) Introducing a new or different measurement basis causes costs. Both preparers and users need time to understand a new or different measurement basis. In addition, new measurement bases could have systems implications for preparers.

38. Consequently, the staff believe that when the IASB is considering introducing a new or different measurement basis, the IASB should consider whether the resulting benefits to users of financial statements justify any additional costs or complexity associated with providing that information. The staff, therefore, recommend that the *Conceptual Framework* should state that there is a need to weigh the benefits of a new or different measurement basis against any increased costs or complexity. This should replace the statement that the number of measurement bases should be the smallest necessary to provide relevant information.
39. The staff believe that the discussion of necessary and unnecessary changes in measurement bases provides useful guidance to the IASB in setting measurement requirements. Consequently, we recommend retaining that discussion in the *Conceptual Framework Exposure Draft*.

Question 5

The staff recommend that the *Conceptual Framework Exposure Draft* should:

(a) explain the need to weigh the benefits of a new or different measurement basis against any increased costs or complexity. This would replace the statement in the Discussion Paper that the number of measurement bases should be the smallest necessary to provide relevant information;

(b) retain a discussion of necessary and unnecessary changes in measurement bases.

Do you agree?

Other enhancing qualitative characteristics

40. The Discussion Paper also discussed the implications of the other enhancing qualitative characteristics for measurement:
- (a) *Timeliness* – timeliness has no specific implication for measurement that is not covered by relevance. If changes in value of an item are relevant, the measurement used should result in recognising them when they occur.
 - (b) *Verifiability* – if a particular measurement cannot be verified, then a different measurement should be considered or disclosures should be made to enable users of financial statements to understand the assumptions used.
 - (c) *Comparability* – comparability implies using measurements that are the same between periods and between entities.
41. The Discussion Paper did not include a specific question on how considering the enhancing qualitative characteristics of timeliness, verifiability and comparability could affect decisions on measurement. Consequently, few respondents commented on this section of the Discussion Paper. Those commenting suggested that:
- (a) verifiability has a significant role to play in the selection of measurement bases; and
 - (b) comparability could be enhanced by removing the ability for preparers to choose between different measurement bases.
42. The staff believe that the discussion of verifiability in the Discussion Paper appropriately reflects the importance of verifiability as one of the factors that should be considered when selecting a measurement basis. In addition, paragraph QC 25 of the existing *Conceptual Framework* already acknowledges that permitting alternative accounting methods for the same economic phenomenon diminishes comparability. Therefore, the staff propose to include in the Exposure Draft the discussion of the other enhancing qualitative characteristics suggested in the Discussion Paper, largely unchanged.

Question 6

The staff recommend that the Exposure Draft should include the discussion of the other enhancing qualitative characteristics suggested in the Discussion Paper, largely unchanged.

Do you agree?

Cost constraint

43. The Discussion Paper suggested that the IASB should consider when selecting a measurement basis whether the benefits of a particular measurement to users of financial statements are sufficient to justify the cost.
44. Nearly all who commented on this preliminary view agreed that the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost. However, a few stated that, because cost is acknowledged in Chapter 1 of the existing *Conceptual Framework* as a pervasive constraint on financial reporting, it is unnecessary (and potentially confusing) to identify it separately as a factor to consider in particular areas of the *Conceptual Framework*, such as when selecting a measurement.
45. The staff believe that cost-benefit considerations are particularly important in selecting a measurement and that, consequently, it is appropriate to separately refer to cost-benefit in the measurement section. We will consider in drafting how to clarify that the cost-benefit constraint applies throughout financial reporting and not just when referred to explicitly in a particular area of the *Conceptual Framework*.

Question 7

The staff recommend retaining a separate reference to the cost-benefit constraint as one of the factors the IASB should consider when selecting a measurement.

Do you agree?

Appendix – Extract from Chapter 3

A1. The following quote is from QC16 of Chapter 3:

A faithful representation, by itself, does not necessarily result in useful information. For example, a reporting entity may receive property, plant and equipment through a government grant. Obviously, reporting that an entity acquired an asset at no cost would faithfully represent its cost, but that information would probably not be very useful. A slightly more subtle example is an estimate of the amount by which an asset's carrying amount should be adjusted to reflect an impairment in the asset's value. That estimate can be a faithful representation if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. In other words, the relevance of the asset being faithfully represented is questionable. If there is no alternative representation that is more faithful, that estimate may provide the best available information.