STAFF PAPER

July 2014

REG IASB Meeting

Project	**Conceptual Framework**		
Paper topic	Measurement – Measurement categories		
CONTACT(S)	Rachel Knubley	rknubley@ifrs.org	+44 207 246 6904

Purpose of paper

1. At the April 2014 meeting, the IASB tentatively decided to adopt an approach to the measurement section of the *Conceptual Framework* that builds on the proposals in the Discussion Paper, modified in the light of feedback received, rather than undertaking further research work on measurement.

2. As part of this approach, you agreed to make a number of changes to the way that measurement was addressed on the Discussion Paper. In particular, you agreed that we should remove much of the discussion of the implications of the proposed approach to measurement for particular types of assets and liabilities from the measurement section (paragraphs 6.73 – 6.109 of the Discussion Paper). This change was made in response to comments made by respondents to the Discussion Paper that these paragraphs include too much standards-level detail.

3. Instead, it was agreed that the measurement section should focus on:

   (a) describing the different measurement bases;

   (b) describing the information that the different measurement bases might provide in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI);

   (c) discussing the factors that might make a particular measurement basis more useful to the users of financial statements.

4. Consequently, this paper discusses the staff's recommended approach to describing the different measurement bases, the information that they provide and the factors that might make a particular measurement basis more useful to the users of financial statements.

5. This paper does not discuss:

   (a) The selection of measurement bases. This will be discussed at a future meeting.

   (b) The staff's proposed approach to cash-flow-based measurements. This is discussed in AP 10L *Measurement - Cash-flow-based measurements*.

Background

6. The Discussion Paper grouped measurements into three categories:

   (a) cost-based measurements;

   (b) current market prices including fair value; and

   (c) other cash-flow-based measurements.

Feedback

7. Respondents were not asked a specific question on these measurement categories. However, a number of respondents provided comments.

8. A few respondents stated that they found the discussion of the three different categories of measurement confusing. In particular, it was not always clear how a particular measurement would be categorised. (For example: is amortised cost a cost-based measurement[1] or a cash-flow-based measurement; is a level three fair value a current market price or a cash-flow-based measurement[2]?)

9. Other respondents suggested that the *Conceptual Framework* should identify only two measurement categories: cost-based measurements and current

[1] AP 10L notes that amortised cost measurement of financial assets and financial liabilities is a cash-flow-based measurement.

[2] Cash-flow-based measurement techniques are usually used in estimating a level three fair value. The result is an estimate of a current market price.

measurements. Cash-flow-based measurements would then be identified as a way of estimating either a cost-based-measurement or a current measurement.

10. In addition, a few respondents stated that the *Conceptual Framework* should provide more discussion on the following areas:

    (a) the role of deprival/relief value in measurement;

    (b) the use of entry and exit values;

    (c) the use of entity-specific and market values;

    (d) the treatment of transaction costs;

    (e) historical cost, including a need for discussion of impairment and depreciation.

Proposed approach for the Exposure Draft

11. The appendix to this paper sets out an initial working draft for the description and discussion of different measurement bases in the Exposure Draft.

12. As noted above, a few respondents to the Discussion Paper stated that they found the discussion of the three different categories of measurement confusing and suggested further discussion of a number of areas. In response to these comments, the staff recommend that the Exposure Draft should:

    (a) discuss the different ways in which measurements can be categorised, namely:

        (i) historical or current measurements;

        (ii) entry values or exit values;

        (iii) entity perspective or market perspective.

        The appendix to this paper includes a working draft for this discussion.

    (b) replace the discussion of current market prices with a discussion of the different types of current measurement bases (paragraphs 13 - 17).

Which measurement bases should be included in the Exposure Draft?

13. To help us decide which measurement bases should be included in the Exposure Draft, the staff have considered how the interaction between entry value, exit value and the perspective adopted for a measurement leads to different current measurement bases:

Perspective	**Entry or exit**	
	Entry	**Exit**
Market	Asset - Replacement price Liability - Assumption price	Fair value
Entity	Asset - Replacement cost Liability - Assumption proceeds	Value in use Fulfilment value

14. We have included a description of these measurement bases in the appendix to this paper. However:

    (a) We have combined the discussion of replacement price (assumption price) with the discussion of replacement cost (assumption proceeds). We believe that in many situations the replacement (assumption) price and replacement cost (assumption proceeds) will be the same;

    (b) We have also included a discussion of net realisable value (the equivalent for a liability is cost of release). This measurement basis is an entity specific exit price that is adjusted for transaction costs. In many cases, net realisable value is essentially the same as a fair value measurement that has been adjusted to reflect transaction costs. However, because this measurement basis is widely used in existing Standards and we believe that it has the potential to provide useful information to users of financial statements, we believe it warrants a separate discussion.

15. We, therefore, propose that the *Conceptual Framework* should describe the following measurement bases:

    (a) historical cost (for an asset) and historical proceeds (for a liability);

    (b) fair value (for an asset or a liability);

    (c) net realisable value (for an asset) and cost of release (for a liability);

    (d) replacement cost (for an asset) and assumption proceeds (for a liability); and

    (e) value in use (for an asset) and fulfilment value (for a liability).

16. We have not included deprival value (relief value) as a separate measurement basis. We plan to discuss deprival value (including whether it is a measurement basis or a way of choosing between different measurement bases) at a future meeting.

17. The measurement bases we have chosen to describe are broadly consistent with the measurement bases described in both the International Public Sector Accounting Standards Board's recent exposure draft on measurement[3] and the IASB's Discussion Paper published in November 2005 *Measurement Bases for Financial Accounting – Measurement on Initial Recognition*[4].

Questions
1) Do you agree that the *Conceptual Framework* Exposure Draft should include a description of the measurement bases listed in paragraph 15?
2) Do you have any comments on the discussion of the different measurement bases included in the appendix?

[3] The IPSASB document refers to:

(a) historical cost for both assets and liabilities;

(b) market value (rather than fair value), net selling price (rather than net realisable value), replacement cost and value in use for assets; and

(c) market value (rather than fair value), cost of release, assumption price (rather than assumption proceeds) and cost of fulfilment (rather than fulfilment value) for liabilities.

[4] This Discussion Paper was prepared by the staff of the Canadian Accounting Standards Board.

Appendix – Description of different measurement bases

This appendix includes an initial working draft for the description and discussion of measurement bases in *Conceptual Framework* Exposure Draft. It is intended to give IASB members an idea of the broad content and level of detail envisaged by the staff. We plan to work further on the drafting. Consequently, we are not seeking detailed drafting comments at this stage.

This appendix does not include drafting for the discussion of cash-flow-based measurements. This is discussed in AP 10L *Measurement – Cash-flow-based measurements*.

Characterisation of measurement bases

A1. Measurement bases can be categorised by three separate distinctions as:

(a) historical or current (paragraphs A2 - A4);

(b) entry values or exit values (paragraphs A5 - A9);

(c) market perspective or entity perspective (paragraphs A10 - A15).

Historical or current

A2. Historical measurement bases use information about the prices of past transactions to provide information about an item in the financial statements. Historical information is normally partially updated to reflect current conditions. For example, the historical cost of an item of property, plant and equipment is updated to reflect consumption. Consequently, depreciated historical cost reflects the historical cost of the unconsumed portion of the rights associated with that item of property, plant and equipment. In addition, the historical cost of an asset is adjusted for impairment if the historical cost of the remaining rights associated with the asset is no longer recoverable.

A3. Current measurement bases are updated to reflect conditions at the reporting date.

A4. As discussed in AP 10L *Measurement - Cash-flow-based measurements* cash-flow-based measurement bases can sometimes include a mixture of current and historical information[5]. For example, the amortised cost basis of measurement for financial assets and financial liabilities uses updated estimates of cash flows, discounted at the original effective interest rate.

Entry or exit

A5. Entry values reflect the actual, estimated or deemed:

(a) historical or current cost of acquiring an asset;

(b) historical or current proceeds for incurring a liability.

A6. Exit values reflect:

(a) the value that would be received from an asset either through sale, use or collection;

(b) the value required either to fulfil a liability or release the entity from the liability.

A7. Entry values provide information for items that are inputs into an entity's business activities. That is, they reflect:

(a) the cost (either historical or current) of an asset of the entity;

(b) either the historical proceeds from a liability, or the proceeds that would be received currently if the entity incurred the same liability at the measurement date.

A8. Exit values provide information for items that are outputs from an entity's business activities. That is, they reflect:

(a) the value that is likely to be received from an asset of the entity (through either use, sale or collection);

(b) the value that is likely to be given up to fulfil or obtain release from a liability.

[5] Note: In AP10L, the staff recommend that cash-flow-based measurements be described as measurement bases rather than measurement techniques. If the IASB disagree with this recommendation we will amend this paragraph.

A9. Exit values include in the measurement of assets (and liabilities) any profit inherent in those items. Entry values do not. Hence, the decision on when to use entry or exit values will depend, at least in part, on when it is thought appropriate to recognise profit on the items being measured.

Entity perspective or market perspective?

A10. Measurements can reflect an entity's own perspective or the perspective of market participants (a market perspective).

A11. If market inputs are observable, a measurement based on the market perspective may be easier to estimate, and be more readily verifiable, than an entity-specific measurement.

A12. For unique items, market based information may not be available and a measurement from the perspective of the entity may be the only realistic option. However, for unique items measurement from a market perspective and measurement from the entity's perspective are likely to be similar. This is because in most cases there is little reason to assume that market participants would use estimates different from those used by the entity.

A13. Entity specific values reflect the entity's own efficiency or inefficiency in realising its assets or fulfilling its obligations. Consequently, when these efficiencies or inefficiencies are significant, an entity specific value may provide more relevant (although potentially less verifiable) information than information from a market perspective. Measurements from a market perspective reflect those efficiencies (or inefficiencies) as they arise.

A14. Using a market perspective to measure assets that are held for use or collection, or liabilities held for fulfilment, will introduce into the measurement of these items market volatility that will reverse over time. Depending on the item that is being measured and the nature of the entity's business activities, users may not find information about such market volatility useful.

A15. One disadvantage of entity-specific estimates is that they may inadvertently reflect synergies with other assets and so may not measure only the item that they purport to measure.

Discussion of the different measurement bases

A16. This exposure draft groups measurements into the following five categories:

Measurement basis				
Assets	**Liabilities**	**Historical or current**	**Entry or exit**	**Perspective**
Historical cost	Historical proceeds	Historical	Entry	Entity
Fair value	Fair value	Current	Exit	Market
Net realisable value	Cost of release	Current	Exit	Entity
Replacement cost	Assumption proceeds	Current	Entry	Entity
Value in use	Fulfilment value	Current	Exit	Entity

A17. The following paragraphs describe each of these measurement bases and the information that they potentially provide to users of financial statements.

Historical cost and historical proceeds

A18. Under the historical cost (proceeds) basis:

(a) an asset is initially measured at an amount equal to the value of the consideration given to acquire the asset at the time of its acquisition or construction;

(b) a liability is initially measured at an amount equal to the value of the consideration received at the time the liability is incurred.

(c) transaction costs are added to the initial measurement of assets and deducted from the initial measurement of liabilities.

A19. The initial measurement of assets measured in accordance with historical cost is not adjusted to reflect changes in prices. However, the initial cost of assets is adjusted over time to reflect:

(a) depreciation or amortisation - depreciation and amortisation are designed to reflect the consumption of the economic resource that constitutes the asset;

(b) impairment of assets – impairment is designed to reflect the extent to which the historical cost of the asset is no longer recoverable.

Consequently, historical cost represents the recoverable, historical cost of the unconsumed part of an asset.

A20. Similarly, liabilities measured in accordance with the historical proceeds measurement basis are not adjusted to reflect changes in prices but are adjusted over time to reflect:

(a) the fulfilment of obligations;

(b) increases to the carrying amount of liabilities that have become more onerous because of increases in estimated cash outflows.

A21. Historical cost at initial measurement reflects the cost of acquiring an asset; historical proceeds reflects the proceeds from incurring a liability – that is, they are entry values.

A22. Historical cost is an entity specific measurement as it incorporates an entity's estimates of its own consumption, impairment, fulfilment etc.

Information provided by historical cost (proceeds) measurement basis

A23. The information provided by historical cost (proceeds) in the statement of financial position and the statement of comprehensive income is summarised in the following table:

	Statement of financial position	**Statement of comprehensive income**
Historical cost	• Recoverable cost of (the unconsumed part of) an asset	• Historical cost of the economic resources consumed in the period (through cost of sales, depreciation, amortisation etc) • Gains or losses on sales of assets during the period • Impairment losses
Historical proceeds	• Historical proceeds for undertaking the unfulfilled part of a liability, plus any increases in estimated cash flows not included in the historical proceeds	• Consideration provided by customers (or others) for obligations fulfilled by the entity during the period • Gains or losses on settlement/transfers of liabilities in the period • Losses on liabilities that have become more onerous during the period

A24. Historical cost (proceeds) has both confirmatory value and predictive value:

(a) It has confirmatory value because it provides information about:

(i) income earned for obligations fulfilled during the period, for example consideration for goods and services supplied during the period;

(ii) the cost of assets (including services) consumed during the period (reported through depreciation or amortisation).

(b) It has predictive value because information about consideration for supplying goods and services in the past, and about the past consumption of assets (including services) can be used to help assess an entity's prospects for future cash flows from the supply of goods and services, and from the consumption of assets (including services).

A25. Because historical cost (proceeds) does not reflect price changes, reported income and expenses do not reflect current income or current costs at the reporting date. Where price changes are significant, historical cost (proceeds) information may be less useful for predicting future cash flows than a current measurement basis (for example, replacement cost). Even when annual price changes are not significant, their cumulative effect may sometimes reduce the usefulness of historical information.

A26. Under the historical cost measurement basis, similar assets that are acquired at different times can be reported in the financial statements at very different amounts. This potentially reduces comparability between reporting entities.

A27. In many situations, information about historical cost is simpler and less expensive to provide than information using current measurement bases. In addition, the historical cost basis of measurement is generally well understood and in many cases is verifiable.

A28. However, cost or proceeds can be difficult to determine when there is no observable transaction price for the asset or liability being measured. In addition, estimating depreciation and identifying impairment losses or onerous liabilities can be highly subjective.

Fair value

A29. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is an exit price - that is, it reflects the price for disposing of an asset or liability. Fair value is determined from the perspective of market participants.

A30. Fair value can sometimes be observed directly from quoted prices in active markets. However, when this is not the case, valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate the fair value of the item being measured.

A31. If a cash-flow-based measurement is used to estimate fair value, it should capture all of the following elements from the perspective of market participants:

(a) an estimate of the amount, timing and uncertainty of future cash flows for the asset or liability being measured. Those estimates should reflect possible variations in the amount and timing of the cash flows;

(b) the time value of money;

(c) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium);

(d) other factors that market participants would take into account in the circumstances; and

(e) for a liability, the risk that the reporting entity may fail to fulfil the liability (non-performance risk).

A32. Transaction costs are excluded from a fair value measurement.

Information provided by fair value measurement basis

A33. The information provided by fair value in the statement of financial position and the statement of comprehensive income is summarised in the following table:

	Statement of financial position	Statement of comprehensive income
Fair value	• Price that would be received to transfer an asset • Price that would be paid to transfer a liability	• Fair value, at the time of performance, of performance obligations fulfilled during the period • Fair value, at the time of performance, of economic resources consumed during the period • Fair value gains and losses on assets and liabilities held during the period. Those gains and losses could arise from: changes in estimates of cash flows, changes in interest rates or changes in risk premiums required by market participants[6] • Transaction costs incurred for assets and liabilities transferred during the period • Changes in the premium required by market participants for the risk of non-performance by the reporting entity

A34. Fair value provides information about the current value of an asset or liability to the entity at the reporting date. It has predictive value because it reflects the cash flows that would be received (paid) if the asset (liability) was sold (transferred) at the reporting date. It also has confirmatory value in that it can be used to compare previous expectations about market returns to actual market outcomes (or revised market expectations).

[6] These fair value gains and losses may sometimes be disaggregated into their component parts, for example, interest income and interest expense, release of risk premiums etc.

A35. Because fair value reflects the price that an entity could sell an asset for at the reporting date, it may not reflect the cash flows that are expected to result from the actual realisation of that asset, if the reporting entity intends to realise the asset other than through sale. In addition, because fair value includes in the measurement of assets (and liabilities) any profit inherent in those items, it might not be a suitable measurement basis for assets that require the entity to undertake significant activities before the asset can be realised.

A36. Fair value gains and losses may not be relevant to some users of financial statements if they are likely to reverse over time (as is the case, for example, with the gains and losses arising from changes in market interest rates on a financial asset or financial liability that the entity is likely to hold to maturity).

A37. Fair value is determined from the perspective of market participants rather than the perspective of the entity and is independent of when the asset or liability was acquired. Consequently, identical assets will be reported at the same value. This arguably produces comparability between entities.

A38. If the fair value of an asset or liability can be observed in an open and active market, then fair value measurement is simple, normally easy to understand and verifiable. If, however, the fair value of an asset or liability cannot be observed, it must be estimated. Depending on the techniques used, this estimation process can be costly and complex. In addition, the verifiability of some techniques used to estimate fair value may be questionable. In extreme cases, the measurement uncertainty associated with estimates of fair value may be so great that measurement at fair value may not provide relevant information.

Net realisable value and cost of release

A39. The net realisable value of an asset is an entity specific selling (exit) price that is adjusted to reflect transaction costs. It includes both a profit margin and a risk adjustment in relation to activities and risks that would remain inherent in the asset after its transfer. In many situations net realisable value (cost of release) will equal the fair value of the asset (liability) adjusted for transaction costs. The equivalent measurement for liabilities is cost of release. The cost of release for a liability is equal to the estimated cost of obtaining release from the obligation by

the counterparty. It includes both a profit margin and a risk adjustment in relation to activities and risks that would be eliminated by release from the obligation.

A40. If the sale of an asset, or the release from a liability, is likely to take place shortly after the end of a reporting period then net realisable value and cost of release are likely to provide a better indication of the actual net cash inflows of outflows associated with the item than fair value. This is because they include the costs associated with realising the asset or obtaining release from the liability. However, if the objective of the measurement is to provide a market based value even when sale or release is not likely for some time, then fair value is likely to provide the more useful information.

Replacement cost and assumption proceeds

A41. The replacement cost of an asset is the most economic current cost of replacing the asset with an asset of equivalent service potential. The replacement cost of an asset is not the cost of a new asset. If, for example, an entity owns a machine with a remaining useful life of five years, the replacement cost of that machine would be the cost of an equivalent asset with a remaining useful life of five years.

A42. The equivalent measurement basis for liabilities is assumption proceeds. The assumption proceeds of a liability is the value of the consideration an entity would currently expect to receive if it assumed obligations identical to its remaining obligations under the liability.

A43. Replacement cost and assumption proceeds:

(a) are entry values - they reflect the current cost of acquiring an asset or assuming a liability;

(b) are increased (decreased) by the transaction costs that would be incurred in replacing the asset (assuming a similar liability).

A44. Replacement cost and assumption proceeds could be determined either from an entity perspective or from a market perspective. (If a market perspective is used it would be more accurate to refer to replacement price or assumption price).

Information provided by replacement cost and assumption proceeds measurement basis

A45. The information provided by replacement cost and assumption proceeds in the statement of financial position and the statement of comprehensive income is summarised in the following table:

	Statement of financial position	**Statement of comprehensive income**
Replacement cost	• Current cost of an asset	• Current cost of the economic resources consumed in the period • Changes during the period in the cost of replacing the service potential of assets held. Those changes might be caused by changes in factors such as: general price levels, prices for specific assets, technology • Impairment losses (compared with previous replacement cost)

	Statement of financial position	Statement of comprehensive income
Assumption proceeds	• Current proceeds for the liability	• The consideration that the entity would have required customers (or others) to provide at the time of fulfilment for obligations fulfilled by the entity during the period • Changes during the period in the price that would be charged for undertaking the obligations inherent in the liability. Those changes might be caused by changes in factors such as: the likely cost of fulfilling the obligations, the margin the entity would require for undertaking the obligation, the willingness of customers to pay for the goods and services provided, the competitiveness of the market for the goods and services

A46. Replacement cost and assumption proceeds reflect the economic conditions prevailing at the reporting date. Consequently, assets, liabilities, income and expenses reported using these measurement bases are reported in current terms. In some circumstances, information reported in current terms may be more useful for predicting future cash flows than information reported on an historical cost basis, particularly in periods of changing prices.

A47. In some cases, replacement cost or assumption cost may be observable (ie the price of the asset or liability in a market is the same as the replacement cost or assumption proceeds to the entity). However, this will often not be the case and the replacement cost or assumption proceeds will need to be estimated. As noted

for fair value measurement, estimation techniques can sometimes be costly, complex to apply and may be difficult to verify. Determining the replacement cost (assumption proceeds) of unique assets (liabilities) may be particularly challenging. It may also be challenging to explain to users the relevance of the replacement cost of unique assets or the assumption proceeds of unique liabilities (for example, what is the replacement cost of a unique (irreplaceable) intangible asset?).

A48. If replacement cost and assumption proceeds are measured from the perspective of the entity, similar assets and similar liabilities within the same entity will be measured similarly. In addition, an entity specific amount that focuses on the costs (proceeds) that the entity itself incurs (receives) might be more relevant than amounts determined from a market perspective. However, using an entity specific amount, similar assets in different entities could be measured differently, thereby reducing comparability.

Value in use and fulfilment value

A49. The value in use of an asset is the present value of the cash flows likely to arise from the continuing use of the asset and from its disposal at the end of its useful life.

A50. The equivalent measurement basis for liabilities is fulfilment value. Fulfilment value is the present value of the cash flows likely to arise from fulfilling the liability.

A51. Value in use and fulfilment value are entity specific exit values. They cannot be directly observed and are determined using discounted cash flow techniques that:

(a) include risk adjustments and a profit margin;

(b) for liabilities, do not normally include the risk of non-performance by the reporting entity.

Information provided by value in use and fulfilment value measurement basis

A52. The information provided by value in use and fulfilment value in the statement of financial position and the statement of comprehensive income is summarised in the following table:

	Statement of financial position	**Statement of comprehensive income**
Value in use	• Present value of cash flows expected to arise from the continuing use of the asset and from its disposal at the end of its useful life	• Gains and losses arising from remeasurement • Unwind of discount
Fulfilment value	• Present value of cash flows expected to arise in fulfilling the liability	• Consideration for performance obligations fulfilled during the period • Cost of economic resources (including services) consumed during the period • Gains and loss arising from changes in fulfilment value. Those gains and losses could arise from changes in: estimates of cash flows, changes in interest rates, changes in risk premiums required by the entity • Unwind of discount • Transaction costs incurred for assets and liabilities transferred during the period

A53. Value in use provides information about the expected cash flows from the continued use of an asset and from its disposal at the end of its useful life. Consequently, it has predictive value and can be used to assess the prospects for future cash flows to an entity. However, value in use is unlikely to provide

relevant information for assets that are expected to be sold rather than used by the entity (unless sale is expected to take place shortly after the measurement date, in which cash value in use is likely to be similar to the asset's net realisable value).

A54. Fulfilment value provides information about the expected cash flows to fulfil an obligation and, consequently, has predictive value. If a liability will be transferred or cancelled rather than fulfilled, fulfilment value is likely to be less relevant than fair value or cost of release. However, it is relatively unusual for liabilities to be transferred or cancelled.

A55. As noted above, value in use and fulfilment value are determined using discounted cash flow techniques. These techniques can sometimes be costly and complex to apply, and may be difficult to verify.

A56. In addition, for many assets that are used in combination with other assets, value in use cannot be determined meaningfully for individual assets. Instead the value in use of a group of assets must be determined and the result allocated to individual assets. Consequently, value in use may not be a practical measurement basis for periodic remeasurements of assets used in combination with other assets. However, it may be useful for one-off remeasurements of assets (for example, when an asset is impaired).

A57. Value in use and fulfilment value are entity specific values. Consequently, similar assets and liabilities in different entities could be measured differently, thereby reducing comparability.