STAFF PAPER

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IASB Meeting

Project	**Conceptual Framework**
Paper topic	Feedback summary: measurement

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Purpose of paper

1. This paper summarises the feedback received on:
   (a) the measurement section of the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*.
   (b) Capital Maintenance, discussed in paragraphs 9.45–9.54 of the Discussion Paper.
2. This paper provides a high level summary of the comments received. Where appropriate, we will provide more detailed breakdown of the comments for future meetings.

Overview

3. Many respondents:
   (a) Supported the mixed measurement approach suggested in the Discussion Paper;
   (b) Agreed that the selection of a measurement basis:
      (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) Suggested that the business model concept could help the IASB decide on a measurement basis.

(d) 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 basis.

(e) Agreed with the IASB's proposal to leave the existing descriptions and the discussion of capital maintenance concepts in the *Conceptual Framework* largely unchanged until such time as work towards a new or revised Standard on accounting for high inflation indicates a need for change.

4. However, some respondents expressed the view that the measurement section:

(a) requires more thought and analysis;

(b) simply codifies existing practice; and

(c) includes too much standards-level detail.

Structure of paper

5. This paper is structured as follows:

(a) General comments (paragraphs 6–8)

(b) Measurement objective (paragraphs 9–14)

(c) The number of measurement bases (paragraphs 15–25)

(d) Selecting a measurement basis (paragraphs 26–35)

(e) Selecting a measurement basis – other factors (paragraphs 36-40)

(f) Subsequent measurement for assets and liabilities (paragraphs 41–48)

(g) Measuring financial assets and financial liabilities (paragraphs 49–50)

(h) Measurement categories (paragraphs 51–56)

(i) Other comments on measurement (paragraph 57)

(j) Capital Maintenance (paragraphs 58–63).

General comments

6. Some respondents expressed the view that the measurement section of the Discussion Paper requires more thought and analysis before it could be included in a revised *Conceptual Framework*.

> The lack of measurement concepts is a major deficiency in the existing Conceptual Framework. We therefore welcome the IASB's intention to develop measurement concepts. However, the virtually zero starting point from the current *Conceptual Framework*, combined with the short amount of time between recommencement of the project and issue of the Discussion Paper, has understandably resulted in this section of the Discussion Paper being one of the most underdeveloped sections of the Discussion Paper. We therefore strongly recommend that the IASB devote considerably more time to this topic in the next phase of the project. In our view, it is essential that the gap in the current Conceptual Framework is filled in a manner that is conceptually robust – otherwise there is a significant risk that it could detract from, rather than improve upon, the existing Conceptual Framework. *New Zealand Accounting Standards Board*

7. Many of those with this view were of the opinion that the guidance in the measurement section simply codifies existing practice and does not provide robust principles that the IASB can use when developing or revising Standards.

8. A number of suggestions were made to address these concerns:

   (a) We should delay issuing an Exposure Draft of the *Conceptual Framework* until we have undertaken more research on measurement.

   (b) We should exclude measurement from the Exposure Draft of the *Conceptual Framework* and undertake a separate research project on measurement.

(c) We should consider a two-step approach to the measurement section. The first step would involve the development of limited interim guidance on measurement that could be used until rigorous concepts and principles can be developed.

Measurement objective

Background

9. 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

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

11. 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.

12. However, some disagreed with the suggested measurement objective. Most of those who disagreed with the objective 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.

13. A few respondents suggested that the two elements of the measurement objective (to provide information about resources and claims and information about how management has discharged their responsibilities) might lead to different conclusions

about the most appropriate measurement basis and that the *Conceptual Framework* should therefore provide a basis for balancing these elements.

14. In addition, a few respondents suggested different measurement objectives, for example:

    (a) separate measurement objectives for the statement of financial position, profit or loss and OCI; and

    (b) separate measurement objectives for particular types of assets and liabilities.

The number of measurement bases

Background

15. 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 number of different measurement bases used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained.

Summary of feedback

Mixed measurement

16. Nearly all of those who commented, including many user groups, agreed that a single measurement basis for all assets and liabilities may not provide the most relevant information to users of financial statements.

17. Some respondents stated that different measurement bases were needed to appropriately reflect different business models. Others expressed the view that the different characteristics and uses of assets and liabilities required the use of more than one measurement basis.

18. A few respondents stated that, although they could see the conceptual arguments for a single measurement basis, it would not be possible to achieve a single measurement basis in practice. Consequently, they support the IASB's preliminary view purely on pragmatic grounds.

19. A few respondents suggested that the IASB had not gone far enough in its preliminary views and should in fact state that a single measurement basis *does not* provide the most relevant information to users of financial statements.

20. A few respondents disagreed with the IASB's preliminary view, citing the following reasons:

    (a) The amounts in the financial statements can only be meaningfully added, subtracted and compared if a single measurement basis is used.

    (b) If a single measurement basis is used, it is possible to understand the economic significance of the amounts included in the financial statements.

    (c) Consistency in the amounts included in the financial statements is important.

21. Most of those who support the use of a single measurement basis conceded that this would be unlikely to be achieved in practice (at least in the short term). However, they expressed the view that the *Conceptual Framework* should aspire to a single measurement basis.

22. A few respondents expressed the view that the analysis in the Discussion Paper was insufficient to reach the conclusion that a single measurement basis may not provide the most relevant information to users of financial statements.

Smallest number necessary

23. Many of those who responded to this question 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.

24. However, a few 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.

Alternative suggestions

25. A number of different approaches to measurement were suggested in the comment letters, including:

(a) fair value as the default measurement basis;

(b) cost as the default measurement basis;

(c) deprival/relief value;

(d) current market-based measurement; and

(e) defining a concept of wealth to derive an ideal measurement basis.

We will analyse these suggestions as we develop the measurement section of the Exposure Draft.

Selecting a measurement basis

Background

26. The Discussion Paper suggested that the relevance of a particular measurement will depend on how investors, creditors and other lenders 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:

(a) for a particular asset should depend on how that asset contributes to future cash flows; and

(b) for a particular liability should depend on how the entity will settle or fulfil that liability.

However, the Discussion Paper did not express a preliminary view about how the IASB would deal with any uncertainty about how an asset will contribute to future cash flows or a liability will be fulfilled or settled.

Summary of feedback

27. Most of those who commented on this question agreed with the suggested approach to selecting a measurement.

28. Many respondents interpreted the preliminary view as meaning that the IASB would consider an entity's business model when selecting an appropriate measurement basis (AP 10K - *Business model* discusses respondents comments on the business model concept). Some of those who support the preliminary view stated that basing measurement requirements on an entity's business model would help provide relevant information to users of financial statements:

> We believe that a measurement approach that takes into consideration the business model concept would necessarily produce relevant information about the entity's prospects for future cash flows, which would in turn provide information that is useful in making decisions about providing resources to the entity. *The Accounting Standards Council Singapore*

29. Other respondents agreed that the selection of a measurement basis should be based on an entity's business model but stated that this should be made more explicit in the *Conceptual Framework*.

30. A few respondents supported the IASB's suggested approach to selecting a measurement basis but stated that the IASB should make it clear that this did not mean that measurements should be selected based on management's intention:

> In our view, an asset should not be written down simply because management intend to use it in a sub-optimal manner; nor should assets be written up to values that the entity has no ability to capture. The concept of a business model (which in our view is not dependent on management intent) assists in identifying the ways in which assets may bring value and cash flows to the entity. *The Financial Reporting Council (UK)*

31. However, other respondents disagreed with this view and stated that the selection of a measurement basis should be based on how management actually intend to use the

asset or settle the liability, arguing that such an approach is more compatible with reporting the results of management's stewardship of the entity's resources.

32. A few respondents agreed with the IASB's preliminary view on selecting a measurement basis, but stated that factors other than the entity's business model should also be considered (for example, consistency between entities, risk, the interaction between assets and liabilities, accounting mismatches).

33. One respondent agreed with the suggested approach to selecting a measurement basis but expressed the view that it could prevent that IASB from providing free choices in Standards (for the example, the cost or fair value choice in IAS 16 *Property, Plant and Equipment*).

34. Some respondents disagreed with the idea that the relevance of a particular measurement will depend on how *investors, creditors and other lenders* are likely to assess how an asset or a liability of that type will contribute to future cash flows. They stated that preparers are unlikely to know what assessments users would make. In addition, they expressed the view that investors, creditors and other lenders do not have the information to assess how an asset or liability will contribute to future cash flows. Consequently, how an asset or liability will contribute to future cash flows should be based on the entity's business model or management's assessment.

35. Some respondents disagreed with the idea that selection of a measurement for a particular asset should depend on how that asset contributes to future cash flows, and that for a particular liability it should depend on how the entity will settle or fulfil that liability. They cited the following reasons:

    (a) They support one of the other approaches to measurement listed in paragraph 25 of this paper.

    (b) Basing the selection of a measurement basis on an entity's business model or management's intention could result in subjectivity and inconsistency in measurement.

    (c) Focusing on how an asset will contribute to future cash flows:

        (i) is not appropriate for some types of entity (for example, not-for-profit entities);

(ii) might result in the IASB ignoring that part of the suggested objective of measurement that deals with stewardship by management; and

(iii) it might result in few assets being measured on a cost basis because cost-based measurement does not provide information about future cash flows.

Selecting a measurement basis – other factors

Background

36. The Discussion Paper suggested the following other factors that the IASB should consider when selecting a measurement basis:

(a) what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI; and

(b) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.

Summary of feedback

Considering both the statement of financial position and the statement(s) of profit or loss and OCI

37. 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.

38. A few respondents stated that, 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.

39. A few respondents stated that the IASB should normally require the same measurement for both profit or loss and the statement of financial position (that is, the use of dual measurements with the difference in OCI should be limited). However, a few other respondents stated that they 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.

Cost-benefit assessment

40. 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.

Subsequent measurement for assets and liabilities

Background

41. The Discussion Paper set out the following implications of the IASB's preliminary views on the subsequent measurement of assets and liabilities:

    (a) If assets contribute indirectly to future cash flows through use or are used in combination with other assets to generate cash flows, cost-based measurements normally provide information that is more relevant and understandable than current market prices.

    (b) If assets contribute directly to future cash flows by being sold, a current exit price is likely to be relevant.

    (c) If financial assets have insignificant variability in contractual cash flows, and are held for collection, a cost-based measurement is likely to provide relevant information.

    (d) If an entity charges for the use of assets, the relevance of a particular measure of those assets will depend on the significance of the individual asset to the entity.

    (e) Cash-flow-based measurements are likely to be the only viable measurement for liabilities without stated terms.

(f) A cost-based measurement will normally provide the most relevant information about:

(i) liabilities that will be settled according to their terms; and

(ii) contractual obligations for services (performance obligations).

(g) Current market prices are likely to provide the most relevant information about liabilities that will be transferred.

Summary of feedback

42. Some respondents expressed the view that this section of the Discussion Paper was too detailed for the *Conceptual Framework*:

> The Framework should identify the factors to be considered in selecting the measurement basis. It should not provide detailed rules and it should not identify the measurements to be used for specific assets and liabilities; this should be a standards-level decision. *PricewaterhouseCoopers*

43. However, most of the respondents commenting on these questions agreed, in general, with the approach to subsequent measurement suggested in the Discussion Paper. Despite this, many respondents disagreed with, or had comments on, some of the detailed discussion of how an asset contributes to future cash flows or how a liability is settled or fulfilled.

44. Comments included the following:

(a) For assets held for use:

(i) Current exit prices may be relevant if they can be determined reliably.

(ii) Current cost (rather than historic cost) may provide useful information to users of financial statements.

(iii) Cost may not be relevant for long-lived assets (for example, real estate) especially if they appreciate in value.

(iv) The proposed approach seems not to allow for the revaluation of non-financial assets, which is currently permitted by some

Standards (for example, IAS 16 *Property, Plant and Equipment*).

(b) For assets held for sale:

  (i) Current exit prices may not be appropriate if they cannot be measured reliably.

  (ii) Current exit prices may not be appropriate for assets that are intended to be held for a period before sale.

  (iii) Current exit prices may not be appropriate if there is no liquid market for the asset.

(c) For assets held for collection, fair value may be more relevant than cost in some situations.

(d) For charge for use assets:

  (i) The relevance of a particular measurement basis for a charge for use asset should not depend upon the significance of the asset to the entity.

  (ii) The suggested approach would result in many more charge for use assets being measured at a current exit price. Some respondents opposed that outcome.

(e) For liabilities without stated terms:

  (i) Cash-flow-based measurements could be used to estimate either cost or current value.

  (ii) Additional guidance on how to construct cash-flow-based measurements for liabilities of this type is needed.

(f) For liabilities that will be settled according to their terms:

  (i) Cash-flow-based measurements might sometimes be appropriate even when the settlement amount is not highly uncertain (eg some lease obligations).

  (ii) It is not always clear whether a liability has stated terms.

(g) With respect to performance obligations, current market prices may be relevant if the entity intends to pay others to perform the service.

(h) For liabilities that will be transferred, the transfer of liabilities happens only rarely and in many cases current market prices or reasonable surrogates are unavailable.

45. Many respondents commented on the discussion of inventories in this section of the Discussion Paper:

> The proposal to measure assets that contribute directly to future cash flows by being sold at a current exit price may be read as implying that inventories should be measured at current exit price. We acknowledge that paragraph 6.80 in the Discussion Paper rebuts this assumption and proposes that the cost-based measurement is more relevant for inventories, and we agree with that outcome. However, the arguments for not following the principle for measuring assets that will be sold at current exit price, and instead selecting the cost-based measurement for inventories, already place a degree of strain on the principles. We suggest that the principles are re-worked so that the measurement of inventories does not ultimately become an exception to it. *KPMG*

46. A few respondents disagreed with the suggestion that cost-based measurements might be more relevant than current market prices in some situations. They expressed the view that current market prices were always more relevant but that cost-based measurement could be justified on the grounds of verifiability or on cost-benefit grounds.

47. A few respondents stated that the *Conceptual Framework* should include a fair value option for assets and liabilities, particularly when the use of that option would reduce an accounting mismatch. However, others argued that the use of current market prices (including fair value) should be restricted to situations in which the gains and losses can be realised easily (for example, when here is an active market in the asset or liability).

48. Some respondents expressed the view that more guidance was needed on how to measure assets and liabilities that are held for more than one purpose.

Measuring financial assets and financial liabilities

Background

49. The Discussion Paper suggested that for some financial assets and financial liabilities (for example, derivatives), basing measurement on the way in which the asset contributes to future cash flows, or the way in which the liability is settled or fulfilled, may not provide information that is useful when assessing prospects for future cash flows. In particular, cost-based information may not be relevant for some types of financial assets and financial liabilities even though they are held for collection or settled according to their terms.

Summary of feedback

50. Although many of those who responded to this question agreed with the preliminary view, some respondents expressed the view that:

    (a) This is a Standards-level issue that should not be dealt with in the *Conceptual Framework*.

    (b) This preliminary view lacks a conceptual basis and appears to be an exception to the general principle that measurement should depend on how an asset contributes to future cash flows or a liability will be settled or fulfilled.

    (c) An entity's business model may mean that cost-based measurements are appropriate for assets and liabilities of this type.

    (d) For some assets and liabilities of this type cost-based measurements may provide relevant information.

Measurement categories

Background

51. The Discussion Paper described and discussed three categories of measurement:

    (a) cost-based measurements;

(b) current market prices including fair value; and

(c) other cash-flow-based measurements.

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

Summary of feedback

53. 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 or a cash-flow-based measurement; is a Level three fair value a current market price or a cash-flow-based measurement?)

54. Other respondents disagreed with how the Discussion Paper categorised measurements. They suggested that the *Conceptual Framework* should identify only two measurement categories: cost-based measurements and current measurements. Cash-flow-based measurements would then be identified as a way of estimating either a cost-based-measurement or a current measurement.

55. 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) when the effects of own credit should be included in the measurement of liabilities;

(f) the use of best estimates (most likely outcomes) in measurement;

(g) discounting: respondents acknowledged the IASB plans to conduct a research project on discounting, but expressed the view that the *Conceptual Framework* should include guidance on discounting; and

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

56. Some respondents commented on measurements that use expected value (probability-weighted average) techniques:

(a) Expected value may ultimately differ significantly from the actual outflow. In some cases, for example when there are only two (binary) outcomes, it may differ from all possible outcomes. These results are not useful for making decisions, and are not readily explainable, and users may choose to ignore them.

(b) Weighted averages should be considered only in very limited situations, such as to average out a range of outcomes in a population of homogeneous items. They are not suitable for a small population.

(c) These techniques would make financial statements more complex and the resulting measurement uncertainty would significantly increase subjectivity in their preparation.

Other comments on measurement

57. Respondents made other comments on the measurement section, including the following:

(a) The definition of measurement suggested in the *Conceptual Framework* (the process of determining amounts to be included in the financial statements) is too broad to be useful.

(b) ‘Measurement’ is the wrong term for the process we undertake when preparing financial statements. What we describe as measurement is not in fact measurement because we cannot (in most cases) directly observe what we are trying to measure.

(c) We should analyse further how the enhancing qualitative characteristics (especially verifiability) could help in the selection of a measurement basis.

(d) We should consider reliability when selecting a measurement basis.

(e) The measurement section should include a discussion of:

(i) foreign currency translation;

(ii) equity accounting.

(f) The link between the measurement section and the section on OCI should be explored. It was stated that decisions about measurement, and in particular when more than one measurement basis is relevant, drives the use of OCI.

Capital Maintenance

Background

58. The Discussion Paper stated that the IASB plans to include the existing descriptions and the discussion of capital maintenance concepts in the revised *Conceptual Framework* largely unchanged until such time as a new or revised Standard on accounting for high inflation indicates a need for change.

Summary of feedback

59. Most respondents either agreed with this approach or did not comment on it. Those who explicitly agreed with the approach stated that they had encountered few problems either with the capital maintenance concepts in the existing *Conceptual Framework* or with high inflation. Consequently, they argued that revising or updating the capital maintenance concepts in the *Conceptual Framework* should not be a priority.

60. A few respondents broadly agreed with the suggested approach to capital maintenance but suggested some changes to the existing guidance including:

(a) stating in the *Conceptual Framework* a preference for one of the concepts of capital maintenance;

(b) removing reference to the physical capital maintenance concept because it is not used in IFRS;

(c) shortening and focusing the discussion of capital maintenance;

(d) removing all discussion of capital maintenance because it was viewed as irrelevant to most entities.

61. Some respondents disagreed with the suggested approach. They argued that the concept of capital maintenance is of fundamental importance to financial reporting.

> …the Conceptual Framework should articulate an ideal concept of capital maintenance and its relationship to the ideal measurement base. Accordingly, we do not support the proposal that leaves the existing descriptions and discussion of this issue largely unchanged until such time as any project on accounting for high inflation indicates a need for change. We think this approach suggests a lack of understanding about the fundamental role a capital maintenance concept has within the accounting framework. We also consider that our current difficulties with profit measurement and OCI, which have issues of capital maintenance at their root clearly indicate a pressing need to resolve these issues. *CPA Australia and The Institute of Chartered Accountants Australia*

62. A few respondents also noted that many jurisdictions are affected by high inflation. Consequently, the IASB should consider capital maintenance concepts when revising the *Conceptual Framework*. One respondent argued for greater use of capital maintenance as defined in terms of units of constant purchasing power.

63. A few respondents expressed the view that the IASB's suggested approach to capital maintenance confuses two concepts:

(a) capital maintenance; and

(b) the measurement unit (nominal vs constant purchasing power), which is the subject of IAS 29 *Financial Reporting in Hyperinflationary Economies*.