STAFF PAPER

September 2014

REG IASB Meeting

Project	**Conceptual Framework**
Paper topic	Measurement – Selection of a measurement basis

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Purpose of paper

1. The purpose of this paper is to discuss the guidance that should be included in the *Conceptual Framework* Exposure Draft on the selection of a measurement basis.

Staff recommendations

2. The staff recommend that the Exposure Draft should state that:
   (a) consideration of the objective of financial reporting, of the qualitative characteristics of useful information and of the cost benefit constraint is likely to result in the IASB selecting different measurement bases for different assets and liabilities.
   (b) the relevance of a particular measurement will depend on how, in the likely assessment of investors, creditors and other lenders, an asset or a liability will contribute to future cash flows. Consequently, the selection of a measurement should depend on how an asset or liability will contribute to future cash flows;
   (c) how an asset or liability contributes to future cash flows is only one of the factors that need to be considered when selecting a measurement basis.

(d) the relative importance of each of the factors to be considered when selecting a measurement basis will depend upon facts and circumstances.

(e) the way in which an entity conducts its business activities should be considered when deciding how an asset or liability contributes to future cash flows. The *Conceptual Framework* need not (and should not) refer explicitly to any particular business activity, such as long-term investment.

(f) one measurement basis is appropriate for the statement of financial position and a different measurement basis is appropriate for the statement of profit or loss when such an approach better reflects the business activities of the entity. This might be the case:

  (i) when the IASB concludes that a current measurement basis provides relevant information in the statement of financial position, but that including a component of the change in the current measurement in OCI allows the entity to provide useful information about an aspect of the entity's business activities in profit or loss;

  (ii) when there is more than one way in which asset or liability is likely to contribute to future cash flows.

(g) the nature of an asset or liability (for example, the nature or extent of the variability in the item's cash flows, the sensitivity of the value of the item to changes in market factors or other risks inherent in the item) is one of the factors that should be considered when selecting a measurement basis.

Structure of paper

3. This paper is structured as follows:

(a) Tentative decisions made so far on the selection of a measurement basis (paragraphs 4);

(b) Mixed measurement approach (paragraphs 5 - 18);

(c) Selection based on how an asset contributes to future cash flows and how a liability will be settled or fulfilled (paragraphs 19 - 28);

(d) The role of an entity's business activities in selecting a measurement basis (paragraphs 29 - 46);

(e) Interaction between the selection of a measurement basis and the use of OCI (paragraphs 47 - 50);

(f) Whether to consider the nature of an asset or liability when selecting a measurement basis (paragraphs 51 - 55).

Decisions made so far on the selection of a measurement basis

4. At the July 2014 meeting, you tentatively decided that the Exposure Draft should:

(a) state that when the IASB selects a measurement basis, 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).

(b) state that:

(i) the level of uncertainty associated with the measurement of an item is one of the factors that should be considered when selecting a measurement basis; and

(ii) if a measurement is subject to a high degree of measurement uncertainty, that fact does not, by itself, mean that the measurement does not provide relevant information.

(c) retain the Discussion Paper's discussion of how the qualitative characteristic of faithful representation affects the selection of a measurement basis.

(d) discuss in the measurement section the fact that a faithful representation by itself does not necessarily result in useful information. The information provided by the representation must also be relevant.

(e) explain the need to weigh the benefits of introducing 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.

(f) retain the Discussion Paper's discussion of necessary and unnecessary changes in measurement bases.

(g) retain the Discussion Paper's discussion of the other enhancing qualitative characteristics.

(h) state explicitly in the measurement section that the cost constraint is one of the factors the IASB should consider when selecting a measurement basis.

Mixed measurement approach

5. The Discussion Paper suggested that a single measurement basis for all assets and liabilities may not provide the most relevant information to users of financial statements.

Feedback

6. 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.

   (a) Some suggested that consideration of the objective of financial reporting, the qualitative characteristics of useful financial information and the cost-benefit constraint would necessarily lead to a mixed measurement approach.

   (b) Some suggested that different measurement bases are needed to appropriately reflect different business models.

   (c) Others expressed the view that the different assets and liabilities have different characteristics and uses, and this will require the use of more than one measurement basis.

(d) 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 supported the IASB's suggested mixed measurement approach purely on pragmatic grounds.

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

8. A few respondents agreed that a mixed measurement approach would be necessary to meet the objective of financial reporting but did not think that the *Conceptual Framework* should explicitly require a mixed measurement approach.

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

   (a) The amounts in the financial statements can be meaningfully added, subtracted and compared only 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.

10. Most of those who supported 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 and that the IASB should be required to explain any decisions not to use the preferred measurement basis.

11. 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.

12. In addition, a few comment letters suggested the use of a single or default measurement basis. These suggestions are described in AP 10D - *Use of a single or default measurement basis*.

Staff analysis

13. The staff agree that there would be advantages in using a single measurement basis for all items in the financial statements. In particular, if a single measurement basis is adopted the totals and subtotals in the financial statements have more meaning that under a mixed measurement approach.

14. However, as discussed in AP 10B – *Measurement bases* different measurement bases provide different information to users of financial statements. For example:

    (a) Exit values provide information about outputs from an entity's business activities; entry values (whether current or historical) provide information about inputs;

    (b) Historical measurement bases provide information about past transactions that can be used to both confirm previous expectations about income and costs in the period and as an input into users' expectations about future cash flows. Current measurement bases provide updated information that can also be used to confirm past predictions and develop expectations about future cash flows.

15. In addition, in particular circumstances, particular measurement bases may be:

    (a) easier to understand and implement;

    (b) more verifiable, less prone to error or subject to less measurement uncertainty;

    (c) less costly to implement.

16. Each of the measurement bases discussed in AP 10B – *Measurement bases* has advantages and disadvantages that make it suitable as a measurement in some circumstances but not in others. Consequently, the staff believe that the IASB is unlikely to conclude that any one measurement basis will, in all circumstances, provide the most useful information to users.

17. The IASB could consider an approach that would describe a single default or aspirational measurement basis – that is, a measurement basis that would be used unless there were good reasons to select a different measurement basis. Such an approach may help to minimise the number of measurement bases used, thereby decreasing the complexity of the financial statements. However, the staff do not

recommend this approach because we do not believe that a particular measurement basis is clearly preferable in most situations. For example, cost-based information (either historical or current) might be more useful to users of financial statements than fair value if those users are particularly interested in the margins created by past transactions. However, cost-based information is unlikely to provide useful information about derivative financial instruments.

18. Although we believe that a mixed measurement approach is likely, this is not the same as the IASB aspiring to a mixed measurement model (as some interpreted the preliminary view in the Discussion Paper). Instead, we believe that consideration of the objective of financial reporting, of the qualitative characteristics of useful information and of the cost constraint will result in the IASB choosing to measure some assets and liabilities using one measurement basis and others using a different measurement basis. We believe that the *Conceptual Framework* Exposure Draft should acknowledge this.

Question 1

The staff recommend that the Exposure Draft should state that consideration of the objective of financial reporting, of the qualitative characteristics of useful information and of the cost benefit constraint is likely to result in the IASB selecting different measurement bases for different assets and liabilities.

Do you agree?

Selection based on how an asset contributes to future cash flows and how a liability will be settled or fulfilled

19. 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.

20. The Discussion Paper went on to discuss the implications of this decision for the subsequent measurement of particular assets and particular liabilities, and for assets and liabilities that contribute to cash flows in particular ways. This discussion, and feedback on it, are summarised in the appendix to this paper. However, when you discussed the strategy for the measurement section in April 2014, you tentatively decided to remove that discussion. Instead, you decided that the Exposure Draft should provide a more detailed description of the different measurement bases and the information that they provide.

Feedback

21. Most of those who commented agreed with the suggestion in the Discussion Paper that the selection of a measurement basis should depend on how an asset contributes to future cash flows and a liability will be settled or fulfilled.

22. 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 recommend the use of a single or default measurement basis, discussed in AP10D - *Use of a single or default measurement basis*.

(b) 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 selecting a measurement basis that does not provide the most suitable input for assessing stewardship by management; and

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

23. 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.

Staff analysis

24. The staff continue to believe that considering how an asset or liability[1] contributes to future cash flows when selecting a measurement basis can increase the relevance of the amounts included in the financial statements. For example, the most relevant measurement basis for a property that will be realised through sale is likely to be its fair value. However, cost based measurement may produce more relevant information in the income statement for a property that will be used in combination with other assets to generate goods and services.

25. The staff believe that the concerns raised in paragraph 22(b) about the focus on how an asset will contribute to future cash flows arise from misunderstandings about the suggestion in the Discussion Paper:

    (a) Paragraph 6.57 of the Discussion Paper stated that, in some cases, flows of value will be in a form other than cash.

    (b) Considering how an asset or liability contributes to future cash flows, is intended to increase the relevance of the measurement basis selected. Information is relevant if users can use it either to assess the prospects for future cash flows to the entity or to assess the stewardship of management (in many cases the same information can be used for both these assessments).

    (c) Considering how an asset or liability contributes to future cash flows, does not necessarily lead to a current measurement basis. For example, for assets that generate cash flows indirectly in combination

[1] Liabilities contribute negatively to cash flows.

with other assets (eg property, plant and equipment), users of financial statements will often use historical cost-based information in their assessments.

26. The staff agree that preparers may not know what conclusions users would reach when assessing how an asset or liability will contribute to the entity's future cash flows. However:

    (a) the Discussion Paper did not suggest that preparers should consider the assessments that users make when selecting a measurement basis. Instead the Discussion Paper suggested that the way in which an asset or liability contributes to future cash flows will affect the way users assess prospects for future cash flows to the entity. Hence, the selection of a measurement basis should depend (at least in part) on how an asset or liability will contribute to future cash flows; and

    (b) in developing or revising measurement requirements, the IASB will consider what assessment the users make.

    Consequently, the staff recommend retaining the reference to the need for the IASB to consider, when considering the relevance of a particular measurement, how that asset or liability will, in the likely assessment of investors, creditors and other lenders, contribute to future cash flows.

27. The reference to how an asset or liability contributes to future cash flows was only one of the suggestions about the selection of a measurement basis in the Discussion Paper. However, because a large part of the measurement section of the Discussion Paper was devoted to discussing the implications of this suggestion for subsequent measurement, many respondents focused on this suggestion alone.

28. The staff believe that it is important to clarify in the Exposure Draft that:

    (a) how an asset or liability contributes to future cash flows is only one of the factors that need to be considered when selecting a measurement basis. (Other factors that the IASB has tentatively decided should be considered are listed in paragraph 4).

    (b) the relative importance of each of the factors to be considered when selecting a measurement basis will depend upon facts and circumstances. Moreover, it is likely that different Board members will place more emphasis on different factors.

Question 2

The staff recommend that the Exposure Draft should state that:

(a) the relevance of a particular measurement will depend on how, in the likely assessment of investors, creditors and other lenders, that asset or liability will contribute to future cash flows. Consequently, the selection of a measurement should depend on how that asset or liability contributes to future cash flows.

(b) how an asset or liability contributes to future cash flows is only one of the factors that need to be considered when selecting a measurement basis.

(c) the relative importance of each of the factors to be considered when selecting a measurement basis will depend upon facts and circumstances.

Do you agree?

The role of an entity's business activities

Feedback

29. The Discussion Paper stated that the selection of a measurement should depend on how an asset contributes to future cash flow and how a liability will be settled or fulfilled. Many respondents interpreted that statement as meaning that the IASB would consider an entity's business model when selecting an appropriate measurement basis. Some of those who supported the preliminary view stated that basing measurement requirements on an entity's business model would help provide relevant information to users of financial statements.

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

31. 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 the selection of measurements should be 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)*

32. 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.

33. 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).

34. A few respondents to the Discussion Paper disagreed with the idea that selection of a measurement basis should be based on an entity's business model. They argued that such an approach could result in subjectivity and inconsistency in measurement.

Long-term investment

35. As noted in Agenda Paper 10F *Implications of long-term investment for the Conceptual Framework* , some respondents argued that the IASB should identify long-term investment as a particular type of business activity (or business model), and develop specific measurement requirements for entities that conduct that business activity. They feared that for long-term investments, using current measurements, particularly market-based current measurements, such as fair value:

(a) may not provide the most relevant information about investments held by reporting entities for the long term, about the liabilities of such entities, and about the financial performance of these entities;

(b) may encourage investors to focus excessively on near-term changes in market value, rather than on long-term prospects for cash flows from assets held for the long term;

(c) may discourage long-term investment by reporting volatility that those commentators view as excessive and artificial, because it arises from transitory unrealised gains and losses that may not normally be realised;

(d) may create incentives for pro-cyclical investment behaviour such as the fire-sale of assets in market downturns;

(e) discourage the provision of long-term insurance products and pension plans, to the detriment of insurance policyholders and pension plan participants, and with detrimental effects on the supply of long-term finance by insurers and pension plans;

(f) lead, in some cases, to accounting mismatches if, for example, insurers are required to report gains or losses on assets in profit or loss without accounting for the related insurance liabilities in the same way.

36. Respondents expressing those fears suggested that:

(a) entities should not use current measurements for their long-term investments (and liabilities). They should use either cost-based measurements, or measurements updated using long-term estimates.

(b) if current measurements are used, remeasurements should be reported in OCI, rather than in profit or loss. Furthermore, on disposal, the total gains or losses should be transferred (‘recycled’) at that date from accumulated OCI to profit or loss (paragraphs 47 - 50 discuss the interaction between the selection of a measurement basis and the use of OCI).

(c) If those long-term investments are measured on a cost basis, any impairment loss should be calculated using an entity-specific measure, such as value in use, rather than a market-based measure (such as fair value).

Staff analysis

37. Although many respondents interpreted the Discussion Paper to mean that that the selection of a measurement should depend on an entity's business model, this was not the only suggestion in the Discussion Paper. The Discussion Paper noted that the way an asset will ultimately contribute to cash flows will often be uncertain. It suggested three possible ways of dealing with this uncertainty:

    (a) Measure assets based on how the value of the asset is likely to be realised as indicated by current activities (business model), plans, strategies, declared intent or past practices;

    (b) Measure based on the most profitable means of contributing;

    (c) Provide information about more than one measurement basis for the item either through disclosure in the notes of the financial statements or the use of OCI (the interaction between selection of a measurement basis and the use of OCI is discussed in paragraphs 47 - 50).

38. The Discussion Paper went on to state that the IASB will decide how to deal with any uncertainty about how an asset will contribute to future cash flows when developing or revising particular Standards.

39. The staff note that how an asset contributes to future cash flows is dependent on the way that an entity conducts its business activities. For example, a truck could be:

    (a) sold as inventory;

    (b) leased to another entity;

    (c) used to make deliveries.

40. Similarly, financial assets can contribute to future cash flows in different ways, for example, by being held to collect cash flows or sold.

41. The way in which liabilities contribute to future cash flow is also dependent on the way in which an entity conducts its business activities. For example:

    (a) Non-financial institutions will normally repay their financial liabilities in accordance with their contractual terms rather than seek to transfer them to a third party (the liability is fulfilled);

    (b) A financial institution is likely to seek a net cash settlement of a commodity contract (by closing out the contract) rather than receive, and pay for, the underlying commodity (the liability is settled);

    (c) A provider of services will normally seek to fulfil its performance obligations by providing services (fulfilment) rather than seeking release from the contract (settlement) from its customer or transferring the obligation to a third party (the liability is transferred).

42. The staff note the concerns raised by some respondents that inconsistencies and subjectivity could result if the way in which an entity conducts its business activities is considered when selecting a measurement. However:

    (a) The staff believe that measuring in the same way assets (or liabilities) that contribute to cash flows differently could reduce comparability by making things that are different appear the same[2].

    (b) In many cases, the way in which an entity conducts its business activities is a matter of fact rather than opinion. When this is not the case, the IASB will need to consider what approach to adopt.

43. The staff, therefore, believe that the way in which an entity conducts its business activities should be considered in determining how an asset contributes to future cash flows and how a liability will be settled or fulfilled.

44. The staff believe that in most situations entities will attempt to maximise the value realised by their assets. Therefore, in most cases there is unlikely to be a significant difference between measuring assets on the basis of the reporting entity's business activities and measuring them on the basis of their most profitable way of contributing. In addition, the staff believe that identifying

[2] QC23 of the Conceptual Framework states: *Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different.*

whether there are alternative ways in which an item could contribute more profitably to future cash flows may be challenging. Therefore, the staff recommend excluding from the Exposure Draft the suggestion that uncertainty about how an asset or liability will contribute to future cash flows could be resolved by considering their most profitable means of contributing.

45. However, the staff continue to believe that uncertainty about how an item will contribute to future cash flows could be dealt with by providing information about more than one measurement basis for the item either through disclosure in the notes of the financial statements or the use of OCI.

46. In the staff's view, the *Conceptual Framework* need not (and should not) refer explicitly to any particular business activity, such as long-term investment, for the following reasons:

    (a) considering, among other factors, the way in which an entity conducts its business activities should enable the IASB to identify which measurement basis will provide the most useful information to users;

    (b) referring explicitly to any particular business activity would, inappropriately, embed standards-level detail in the *Conceptual Framework*, and

    (c) the *Conceptual Framework* does not refer to any other particular business activity, and it is not obvious why it should refer specifically to this one.

Question 3

The staff recommend that:

(a) the Exposure Draft state that the way in which an entity conducts its business activities should be considered when deciding how an asset contributes to future cash flows and a liability will be settled or fulfilled;

(b) the *Conceptual Framework* need not (and should not) refer explicitly to any particular business activity, such as long-term investment.

Do you agree?

Interaction between the selection of a measurement basis and the use of other comprehensive income (OCI)

Background

47. The IASB has tentatively decided that the use of OCI should be restricted to:

    (a) items of income or expense (or a component of that item) that arise from a change in a current measure of an asset or liability;

    (b) those limited circumstances when the IASB concludes that including an item in OCI would enhance the relevance of profit or loss.

48. The IASB has also tentatively decided that one of the limited circumstances in which it might be appropriate to use OCI for an item of income or expense would be when the IASB concludes that one measurement basis is appropriate for the statement of financial position and a different measurement basis is appropriate for the statement of profit or loss. However, previous discussions have not identified when this might occur. The following section discusses this.

Staff analysis

49. The staff believe that the IASB might conclude that one measurement basis is appropriate for the statement of financial position and a different measurement basis is appropriate for the statement of profit or loss when such an approach provides more relevant information about the business activities of the entity. This might be the case when:

    (a) the IASB has concluded that a current measurement basis provides relevant information in the statement of financial position, but has also concluded that including a component of the change in the current measurement in OCI provides more relevant or understandable information about an aspect of the entity's business activities. This is the approach proposed in the Insurance Contracts project. In that project, the IASB has tentatively decided to require a current measurement basis for the insurance liability. However, in order to provide a clearer segregation of the underwriting performance of the insurer from the investing performance, it has tentatively decided to permit entities to present in OCI changes in the insurance liability attributable to changes in discount rate.

(b) there is more than one way in which an asset or liability is likely to contribute to future cash flows. For example, financial assets measured at fair value through OCI under IFRS 9 *Financial Instruments* are held within a business model whose objective is achieved by both collecting contractual cash flows and selling. Consequently, both information about the amortised cost of the asset (which reflects cash flows that would be received if assets are held to collect) and information about the fair value of the asset (which reflects cash flows that would be received if assets are sold) is useful to users of financial statements.

50. The staff believe that providing guidance in the *Conceptual Framework*, along the lines outlined in paragraph 49, would be useful to the IASB when developing or revising Standards.

Question 4

The staff recommend that the Exposure Draft should state that one measurement basis is appropriate for the statement of financial position and a different measurement basis is appropriate for the statement of profit or loss when such an approach better reflects the business activities of the entity. This might be the case when:

(a) the IASB concludes that a current measurement basis provides relevant information in the statement of financial position, but that including a component of the change in the current measurement in OCI allows the entity to provide better information about an aspect of the entity's business activities in profit or loss;

(b) there is more than one way in which asset or liability is likely to contribute to future cash flows.

Do you agree?

Whether to consider the nature of an asset or liability when selecting a measurement basis

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

    (a) if the ultimate cash flows are not closely linked to the original cost;

    (b) if, because of significant variability in contractual cash flows, cost-based measurement techniques may not work because they would be unable to simply allocate interest payments over the life of such financial assets of financial liabilities; or

    (c) if changes in market factors have a disproportionate effect on the value of the asset or the liability (ie the asset or liability is highly leveraged).

52. Although many of those who commented on this suggestion agreed with it, 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 or liability contributes to future cash flows.

    (c) An entity's business activities may mean that cost-based measurements are appropriate, even for some or all of the assets and liabilities described in paragraphs 51. Some respondents made this point particularly in relation to business activities that involve long-term investment.

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

Staff analysis

53. The staff agree with those respondents to the Discussion Paper who stated that this preliminary view deals with a Standards-level issue and appears to be an exception to the notion that measurement should depend on how an asset contributes to future cash flows or a liability will be settled or fulfilled. We therefore recommend that this suggestion is not carried forward to the Exposure Draft.

54. However, the staff believe that underpinning this preliminary view is an important idea that should be included in the *Conceptual Framework* – that is, that the nature of an asset or liability (for example, the nature or extent of the variability in the item's cash flows, the sensitivity of the value of the item to changes in market factors or other risks inherent in the item) is one of the factors that should be considered when selecting a measurement basis.

55. Considering the nature of the asset and liability as well as how it contributes to future cash flows is consistent with the approach to classification of financial instruments taken in IFRS 9. Under the approach in that Standard, the classification and measurement of financial assets depends not only on how the asset contributes to future cash flows (held to collect, held to collect and sell etc…) but on the nature of the item (the contractual cash flow characteristics).

Question 5
The staff recommend that the Exposure Draft should state that the nature of an asset or liability (for example, the nature or extent of the variability in the item's cash flows, the sensitivity of the value of the item to changes in market factors or other risks inherent in the item) is one of the factors that should be considered when selecting a measurement basis. Do you agree?

Appendix – Subsequent measurement for assets and liabilities

A1. The Discussion Paper discussed implications of the IASB's prelimary views for the subsequent measurement of particular assets and particular liabilities, and for assets and liabilities that contribute to cash flows in particular ways. The IASB tentatively decided in April 2014 to remove that discussion. That discussion, and the feedback on it, are summarised in this appendix.

A2. 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.

Feedback

A3. 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*

A4. 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.

A5. 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.

A6. 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*

A7. 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.

A8. 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).

A9. 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.