STAFF PAPER

11-12 June 2015

Prepared for the joint Capital Markets Advisory Committee and Global Preparers Forum Meeting

Project	**Conceptual Framework**		
Paper topic	Measurement		
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Purpose of the paper

1. The purpose of this paper is to get your feedback on the measurement proposals in the IASB's Exposure Draft *Conceptual Framework for Financial Reporting* (the 'Exposure Draft').

2. This paper provides the basis for the discussion about measurement at this joint Capital Markets Advisory (CMAC) and Global Preparers Forum (GPF) meeting. Specifically, this paper:

   (a) Sets out the discussion questions for the members of the CMAC/GPF.

   (b) Provides the supporting context from the Exposure Draft to foster the discussion during the break-out session. To concentrate the discussion on the most significant aspects, the material provided omits some of the more detailed points discussed in the Exposure Draft.

Information about the Capital Markets Advisory Committee (CMAC) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/CMAC/Pages/CMAC.aspx

Information about the Global Preparers Forum (GPF) is available at http://www.ifrs.org/The-organisation/Advisory-bodies/Pages/Global-preparers-forum.aspx

Questions for the members of CMAC and GPF

3. During this session we would like you to discuss the following questions:

Question 1—Measurement bases
Has the IASB correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why? (See Appendix A paragraphs 6.4 – 6.46)

Question 2— Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why? (See Appendix A paragraphs 6.48 – 6.63)

Background

4. The existing *Conceptual Framework* provides very little guidance on measurement. The Exposure Draft proposes guidance to fill this gap that discusses:

   (a) measurement bases and the information that they provide; and

   (b) factors to consider when selecting a measurement basis.

5. To help you discuss the questions in this paper, Appendix A includes relevant paragraphs from the measurement chapter of the Exposure Draft.

6. To provide you with additional background, Appendix B includes relevant paragraphs from the Basis for Conclusions on the Exposure Draft. It will help you to understand the IASB's reasons for the decisions it made when developing the proposals on measurement.

7. You will have approximately 45 minutes to discuss the questions in your group.

Appendix A – Extracts from the Exposure Draft

The following are extracts from the Exposure Draft *Conceptual Framework for Financial Reporting*.

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Chapter 6—Measurement

Introduction

6.1 [not reproduced in this paper]

6.2 Measurement is the process of quantifying, in monetary terms, information about an entity's assets, liabilities, equity, income and expenses. A measure is the result of measuring an asset, a liability, equity or an item of income or expense on a specified measurement basis. A measurement basis is an identified feature of an item being measured (for example, historical cost, fair value or fulfilment value). Applying a measurement basis to an asset or a liability creates a measure for that asset or liability and for any related income or expense.

6.3 Consideration of the objective of financial reporting, the qualitative characteristics of useful financial information and the cost constraint is likely to result in the selection of different measurement bases for different assets, liabilities and items of income and expense.

Measurement bases and the information that they provide

6.4 Measurement bases can be categorised as:

(a) historical cost (paragraphs 6.6-6.18); or

(b) current value (paragraphs 6.19-6.46).

6.5 [not reproduced in this paper]

Historical cost

6.6 Measures based on historical cost provide monetary information about assets, liabilities, income and expenses using information derived from the transaction or event that created them. The historical cost measures of assets or liabilities do not reflect changes in prices. However, the measures do reflect changes such as the consumption or impairment of assets and the fulfilment of liabilities.

6.7 The historical cost of a non-financial asset at the time of the asset's acquisition or construction is the value of all the costs incurred in acquiring or constructing the asset, including both the consideration given and the transaction costs incurred. That amount is adjusted over time to depict, if and when applicable:

(a) the consumption of the economic resource that constitutes the asset (depreciation or amortisation); and

(b) the fact that part of the historical cost of the asset is no longer recoverable (impairment).

6.8 The historical cost of a non-financial liability at the time it is incurred is the value of the consideration received, comprising the consideration less the transaction costs incurred in taking it on. That amount is adjusted over time to depict, if and when applicable:

(a) accrual of interest;

(b) fulfilment of the liability; and

(c) any excess in the estimated cash outflows over the net consideration received (onerous liabilities). As a result, the carrying amount of a liability is increased when it becomes so onerous that the historical consideration is no longer sufficient to depict the requirement to fulfil the liability.

6.9 The historical cost of a financial asset (sometimes referred to as amortised cost) is initially the value of the consideration given to acquire the asset plus the transaction costs relating to the acquisition. The historical cost of a financial liability (again, sometimes referred to as amortised cost) is initially the value of the consideration received to take on the liability less the transaction costs incurred in taking it on. The subsequent carrying amount of financial assets and financial liabilities measured using amortised cost reflects subsequent changes such as the accrual of interest, changes in the estimates of cash flows (including the impairment of financial assets) and payments or receipts, but does not reflect subsequent changes in prices caused by other factors.

6.10 The derecognition of assets (liabilities) measured at historical cost results in the recognition as income or expenses of any difference between the carrying amount of the asset (liability) and any consideration received (paid) as income or expense.

6.11 The assets acquired and the liabilities incurred in transactions that involve no exchange do not have a readily identifiable initial cost. In such cases, current values are sometimes used as a proxy for cost (deemed cost) on initial measurement and that deemed cost is then used as a starting point for subsequent measurement.

6.12 The information provided by historical cost measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1 [not included in this paper]. Paragraphs 6.10–6.17 summarise the main advantages and disadvantages of historical cost.

6.13 Income and expenses measured at historical cost may have predictive value. For example, for non-financial assets, information about the consideration received from supplying goods and services in the past, and about the past consumption of assets (including services received), can be used as some of the inputs needed in assessing an entity's prospects for future cash flows from the future supply of goods and services and from the future consumption of existing and future assets (including services to be received). Information about past margins can be used as one input in predicting future margins.

6.14 Income and expenses measured at historical cost may also have confirmatory value by providing feedback about previous estimates of cash flows or margins.

6.15 In many situations, it is simpler and less expensive to provide information about historical cost than information using current value measurement bases. In addition, measures prepared using the historical cost measurement basis are generally well understood and, in many cases, verifiable.

6.16 Historical cost can be difficult to determine when there is no observable transaction price for the asset or the liability being measured. In addition, estimating consumption and identifying impairment losses or onerous liabilities can be subjective. Hence, the historical cost of an asset or a liability can sometimes be as difficult to estimate as a current value.

6.17 On the historical cost measurement basis, similar assets or liabilities that are acquired or incurred at different times can be reported in the financial statements at very different amounts. This can reduce comparability both between reporting entities and within the same reporting entity.

6.18 The current cost of an asset (liability) is the cost of (proceeds from) an equivalent asset (liability) at the measurement date. Current cost and historical cost are both entry values (ie they reflect values in the market in which the entity acquires the asset or incurs the liability). Hence, they are different from the current value measurement bases described in paragraphs 6.19–6.46. Information about the current cost of assets or liabilities may sometimes be more relevant than information about their historical cost, particularly when price changes are significant. For example, reporting income and expenses based on current costs:

(a) may sometimes be more useful for predicting future margins than information based on historical costs.

(b) may be necessary if a physical capital maintenance concept is used in financial statements. Chapter 8 discusses capital maintenance.

Current value

6.19 Measures based on current value provide monetary information about assets, liabilities, income and expenses using information that is updated to reflect conditions at the measurement date. Because of the updating, current values capture any positive or negative changes, since the previous measurement date, in estimates of cash flows and other factors included in those current values (see paragraph 6.23).

6.20 Current value measurement bases include:

(a) fair value (see paragraphs 6.21–6.33); and

(b) value in use for assets and fulfilment value for liabilities (see paragraphs 6.34–6.46).

Fair value

6.21 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.

6.22 Fair value reflects the perspective of market participants. That is, the asset or the liability is measured using the same assumptions that market participants would use when pricing the asset or the liability if those market participants act in their economic best interest.

6.23 Fair value reflects the following factors:

(a) estimates of future cash flows.

(b) possible variations in the estimated amount and timing of future cash flows for the asset or the liability being measured, caused by the uncertainty inherent in the cash flows.

(c) the time value of money.

(d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (generally expect to receive more for taking on a liability) that has uncertain cash flows than for an asset (liability) whose cash flows are certain.

(e) other factors, such as liquidity, that market participants would take into account in the circumstances.

6.24 For a liability, the factors mentioned in paragraph 6.23(b) and 6.23(d) include the possibility that the entity may fail to fulfil the liability (own credit risk).

6.25 As noted in paragraph 6.23(d), the fair value of an asset or a liability reflects a risk premium. Thus, when an entity takes on a liability in a transaction that involves no exchange and measures it on initial recognition at fair value, the expense recognised at that date includes the risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Including the risk premium in the measure of the liability depicts the full burden of the liability. However, users may sometimes find it counterintuitive to recognise an initial expense including the risk premium, and then subsequently to recognise the same amount as income.

6.26 [not reproduced in this paper]

6.27 The information provided by the fair value measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1 [not included in this paper]. Paragraphs 6.24–6.33 summarise the main advantages and disadvantages of fair value.

6.28 Information given about assets and liabilities when they are measured at fair value has predictive value, because fair value reflects expectations about the amount, timing and uncertainty of the cash flows (reflecting market participants' expectations and priced in a manner that reflects their risk preferences). It may also have confirmatory value by providing feedback about previous estimates.

6.29 Income and expenses measured at fair value could be split in various ways to provide information with predictive and confirmatory value. For example, they could be split into:

(a) the return that market participants would have expected from holding the asset during the period;

(b) the difference between that return and the return generated by the entity's actual use of the asset during the period (providing information about the efficiency with which the entity has used the asset); and

(c) the effect of changes in estimates of market participants' expectations about the amount, timing and uncertainty of future returns, combined with changes in estimates of market participant's risk preferences.

6.30 However, depending on the item that is being measured and the nature of the business activities conducted by the entity, users may not always find information about estimates of changes in expectations of market participants relevant. Hence, they may not always find income and expenses measured at fair value relevant. In particular, this may be the case when the business activities conducted by the entity do not involve selling the asset or transferring the liability; for example, if assets are held solely for use or to collect contractual cash flows, or if liabilities are to be fulfilled by the reporting entity itself.

6.31 Because fair value is determined from the perspective of market participants, instead of the perspective of the entity, and is independent of when the asset or the liability was acquired or incurred, identical assets will (subject to estimation error) be measured at the same amount. This can enhance comparability both between reporting entities and within the same reporting entity.

6.32 If the fair value of an asset or a liability can be observed in an active market, the process of fair value measurement is simple and easy to understand, and the fair value is verifiable. If fair value cannot be observed, valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate that fair value. Depending on the techniques used:

(a) the estimation process may be costly and complex.

(b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process itself. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.

6.33 If an entity is estimating the fair value of a specialised item, there may sometimes be little reason for the entity to assume that market participants would use assumptions different from those that the entity itself uses. In that case, measurement from a market participant perspective and measurement from the entity's perspective are likely to produce similar measures.

Value in use and fulfilment value

6.34 Value in use and fulfilment value are entity-specific values. Value in use is the present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash flows that an entity expects to incur as it fulfills a liability.

6.35 Value in use and fulfilment value cannot be directly observed and are determined using cash-flow-based measurement techniques. In principle, value in use and fulfilment value reflect the same factors as described for fair value in paragraph 6.23, but are based on entity-specific assumptions instead of assumptions by market participants. In practice, to provide the most useful information, value in use and fulfilment value may sometimes need to be customised, for example, it may sometimes be appropriate:

(a) to use market participant assumptions about the time value of money or the risk premium; or

(b) to exclude from the fulfilment value the effect of the possibility of non-performance by the entity.

6.36 When an entity incurs a liability in a transaction that involves no exchange and measures it on initial recognition at the fulfilment value, the expense recognised at that date includes a risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Users may sometimes find that effect counterintuitive (see paragraph 6.25).

6.37 Value in use reflects the present value of the transaction costs that the entity expects to incur on the ultimate disposal of the asset.

6.38 Fulfilment value not only includes the present value of the amounts to be transferred to the liability counterparty, but also the present value of the amounts that the entity expects to transfer to other parties to enable it to fulfil the liability. Thus, it also includes the present value of transaction costs (if any) that the entity expects to incur in undertaking transactions that enable it to fulfil the liability.

6.39 The information provided by value in use measures of assets, income and expenses and fulfilment value measures of liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1 [not reproduced in this paper]. Paragraphs 6.40–6.46 summarise the main advantages and disadvantages of value in use and fulfilment value.

6.40 Value in use provides information about the present value of the estimated cash flows from the continued use of an asset and from its disposal at the end of its useful life. This information has predictive value and can be used in assessing the prospects for future cash flows, particularly if the asset will contribute to future cash flows by being used.

6.41 Fulfilment value provides information about the present value of the estimated cash flows to fulfil a liability. That information has predictive value; particularly if the liability will be fulfilled instead of transferred or settled by negotiation.

6.42 Updated estimates of value in use and fulfilment value, combined with information about actual cash flows, have confirmatory value because they provide feedback about previous estimates of value in use and fulfilment value.

6.43 Value in use and fulfilment value are determined using cash-flow-based measurement techniques. As noted in paragraph 6.32, depending on the techniques used:

(a) the estimation process can be costly and complex; and

(b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.

6.44 Because value in use and fulfilment value are determined from the perspective of the reporting entity, those measures could differ for identical assets and liabilities in different entities, arguably reducing comparability. In contrast, because fair value uses market participant assumptions, in theory, different entities should arrive at identical estimates of fair value for identical items.

6.45 For many assets that are used in combination with other assets, the value in use cannot be determined meaningfully for individual assets. Instead, the value in use is determined for a group of assets and the result is then allocated to individual assets. Hence, determining the value in use of an asset used in combination with other assets can be a costly and complex process and the value in use may not be a practical measurement basis for periodic remeasurements of such assets. However, it may be useful for occasional remeasurements of assets (for example, when it is used in an impairment test to determine whether a historical cost measure is fully recoverable).

6.46 In addition, estimates of value in use and fulfilment value may inadvertently reflect synergies with other assets and liabilities and so may not measure only the item that they purport to measure.

6.47 [not reproduced in this paper]

Factors to consider when selecting a measurement basis

6.48 The discussion in paragraphs 6.4–6.46 describes, for each measurement basis, the information it provides and its advantages and disadvantages. The following paragraphs discuss factors to be considered in selecting a measurement basis for an asset or a liability and the related income and expenses. The relative importance of each of the factors will depend upon facts and circumstances.

6.49 For information provided by a particular measurement basis to be useful to the users of financial statements, it must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should, as far as possible, be comparable, verifiable, timely and understandable.

6.50 As with all other areas of financial reporting, cost constrains the selection of a measurement basis. Hence, the benefits of the information provided to the users of financial statements by a particular measurement basis must be sufficient to justify the cost of providing that information.

6.51 [not reproduced in this paper]

6.52 [not reproduced in this paper]

Relevance

6.53 When selecting a measurement basis, it is important to consider what information that measurement basis will produce in both the statement of financial position and the statement(s) of financial performance.

6.54 To produce relevant information, it is important to consider the following factors when selecting a measurement basis for an asset or a liability and the related income and expenses:

(a) how that asset or liability contributes to future cash flows. This will depend in part on the nature of the business activities conducted by the entity. For example, if a property is realised by sale, it will produce cash flows from that sale, but if a property is used in combination with other assets to produce goods and services, it will help produce cash flows from the sale of those goods and services.

(b) the characteristics of the asset or the liability (for example, the nature or extent of the variability in the item’s cash flows, or the sensitivity of the value of the item to changes in market factors or to other risks inherent in the item).

6.55 One factor affecting the relevance of the information provided by a measurement basis is the level of measurement uncertainty in estimates of that information. A high level of measurement uncertainty does not prevent the use of an estimate that provides the most relevant information. However, in some cases, the level of measurement uncertainty is so high that a different measurement basis may provide more relevant information. Moreover, if no measurement basis for an asset or a liability would provide relevant information, it is not appropriate to recognise the asset or the liability.

6.56 Measurement uncertainty is not the same thing as outcome uncertainty. For example, if the fair value of an asset is observable in an active market, no uncertainty is associated with the measurement of that fair value, even though it is uncertain how much cash the asset will ultimately produce. Nevertheless, outcome uncertainty may sometimes contribute to measurement uncertainty. For example, there may be a high level of uncertainty about the cash flows that a unique asset will produce (outcome uncertainty) and estimating a current value of that asset may depend on a model whose validity is untested and that requires inputs that are difficult to verify.

Faithful representation

6.57 A perfectly faithful representation is free from error, but this does not mean that measures must be perfectly accurate in all respects. For example, an estimate of an unobservable price can be faithfully represented if it is described as being an estimate, if the nature and limitations of the estimating process are explained and if no errors have been made in selecting and applying the process for developing the estimate.

6.58 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (an ‘accounting mismatch’). Measurement inconsistencies can result in financial statements that do not faithfully represent the entity’s financial position and financial performance. Consequently, in some circumstances, using a similar measurement basis for related assets or liabilities may provide more useful information for users of financial statements than using dissimilar measurement bases. This may be particularly likely when the cash flows from one item are contractually linked to the cash flows from another item.

Enhancing qualitative characteristics

6.59 The enhancing qualitative characteristics of comparability, verifiability and understandability also have implications for the selection of a measurement basis. However, the enhancing qualitative characteristic of timeliness has no specific implications for measurement.

6.60 Comparability implies using measurement bases that are the same between periods and between entities. Reducing the number of measurement bases used contributes to comparability.

6.61 Verifiability implies using measurement bases that result in measures that can be independently corroborated either directly (such as by observing prices) or indirectly (such as by checking inputs to a model). If a particular measure cannot be verified, disclosures may be needed in the notes to the financial statements to enable users of financial statements to understand the assumptions used. In some such cases, it may be necessary to select a different measurement basis.

6.62 Understandability depends partly on the number of different measurement bases used and on whether they change over time. In general, if the number of measurement bases used in a set of financial statements increases, the resulting information becomes more complex (and, hence, less understandable), and the totals or subtotals in the statement of financial position and the statement(s) of financial performance become less meaningful. However, it could be appropriate to increase the number of measurement bases used if that is necessary to provide more relevant information.

6.63 A change in measurement basis can make financial statements less understandable. However a change may be justified if other factors outweigh the reduction in understandability; for example, if the change results in more relevant information. In such cases, disclosures may be needed in the notes to the financial statements to enable users to understand any income or expense recognised as a result of the change in measurement basis.

Paragraphs 6.64-6.80 not reproduced in this paper.

Appendix B – Extracts from the Basis for Conclusions

The following are extracts from the Basis for Conclusion on the Exposure Draft *Conceptual Framework for Financial Reporting*. The information in this Appendix will help you to understand the IASB's reasons for the decisions that it made when developing the proposals on measurement.

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Basis for Conclusions

Paragraphs BC6.1-BC.6.6 not reproduced in this paper.

Mixed measurement basis (paragraph 6.3)

BC6.7 When developing both the Discussion Paper[1] and the Exposure Draft, the IASB considered whether the *Conceptual Framework* should advocate a single or default measurement basis. The main advantages of a single measurement basis are:

(a) the amounts included in the financial statements can be more meaningfully added, subtracted and compared; and

(b) a single measurement basis makes the financial statements less complex and, arguably, more understandable.

BC6.8 However, the Discussion Paper suggested that a single measurement basis for all assets, liabilities, income and expenses may not always provide the most relevant information to users of financial statements. Hence, the Discussion Paper suggested that the *Conceptual Framework* should adopt a mixed measurement basis approach.

BC6.9 Nearly all respondents to the Discussion Paper who commented on this issue agreed that a single measurement basis for all assets, liabilities, income and expenses may not provide the most relevant information to users of financial statements.

BC6.10 A few respondents disagreed with the suggestion to adopt a mixed measurement basis approach and proposed one of the following as a single or default measurement basis:

(a) historical cost;

(b) fair value;

(c) current entry value (such as current cost, see paragraph BC6.18(a)); or

(d) deprival (relief) value (see paragraph BC6.18(c)).

[1] References to the Discussion Paper are to the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* published in July 2013.

BC6.11 One respondent suggested that a single measurement basis could be derived if the IASB identified an ideal concept of wealth that would meet the information needs of users of financial statements.

BC6.12 Most of the respondents who suggested the use of a single measurement basis conceded that this could not 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 that measurement basis.

BC6.13 When developing the Exposure Draft, the IASB noted that different information, derived from different measurement bases, may be relevant to users of financial statements in different circumstances. 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; or

(c) less costly to implement.

BC6.14 Hence, the IASB has concluded that consideration of the objective of financial statements, the qualitative characteristics of useful information and the cost constraint is likely to result in the selection of different measurement bases for different assets and liabilities.

Measurement bases and the information they provide (paragraphs 6.4–6.46)

BC6.15 The Discussion Paper grouped measures into three categories:

(a) cost-based measures;

(b) current market prices including fair value; and

(c) other cash-flow-based measures.

BC6.16 A few respondents to the Discussion Paper stated that they found the discussion of the three different categories of measures to be confusing. In particular, it was not always clear how a particular measurement basis would be categorised. Other respondents suggested that the *Conceptual Framework* should identify only two measurement categories: cost-based measures and current measures. Cash-flow-based measures would then be identified as techniques used in estimating either a cost-based measure or a current measure.

BC6.17 The IASB agrees that:

(a) the discussion would be clearer if measurement bases were characterised as either historical cost measurement bases or current value measurement bases. Hence, the Exposure Draft describes these two categories of measurement basis. Paragraphs BC6.19–BC6.23 discuss historical cost and paragraphs BC6.24–6.29 discuss current value measurement bases.

(b) cash-flow-based measurement techniques are generally used to estimate the measure of an asset or a liability on a defined measurement basis. Consequently, the Exposure Draft does not identify those techniques as a separate category of measurement basis.

BC6.18 A few respondents to the Discussion Paper stated that the discussion of measurement bases should include more about the following areas:

(a) the use of entry and exit values. The IASB rejected the idea of categorising measurement bases according to whether they provide information about the inputs to an entity’s business activities (ie entry values such as historical cost and current cost) or information about the outputs from an entity’s business activities (ie exit values such as fair value, value in use and fulfilment value). The IASB thinks that there is often little difference between entry and exit values in the same market, except for transaction costs.

(b) the use of entity-specific values and market values. The Exposure Draft identifies, where relevant, measurement bases as entity-specific values or market values and discusses the different information that they provide.

(c) the role of deprival (relief) value as a measurement basis. The deprival (relief) value of an asset (liability) is the loss (benefit) that an entity would suffer (enjoy) if it were deprived (relieved) of the asset (liability) being measured. The IASB discussed the use of deprival (relief) value. However, the IASB did not include a discussion of this approach to measurement in the Exposure Draft, because it is more complex than other measurement bases and is not well accepted in some jurisdictions. Hence, the IASB thinks that it is unlikely to use this approach when developing new Standards.

(d) the treatment of transaction costs.

Historical cost

BC6.19 The Exposure Draft identifies historical cost measures as measures that provide monetary information about assets, liabilities, income and expenses using information from the past transaction or event that created them.

BC6.20 The Exposure Draft explains that historical cost is initially the value of all the costs incurred to acquire or construct an asset, or the value of the net consideration received to take on a liability. Whether that initial value is fair value, or some other value, will be a Standards-level decision.

BC6.21 In response to comments from some respondents to the Discussion Paper, the IASB expanded the description of historical cost for non-financial assets and non-financial liabilities. In particular, the Exposure Draft explains that the historical cost:

(a) of assets is decreased as the asset is consumed (depreciation or amortisation) or if it becomes impaired; and

(b) of liabilities is decreased as they are fulfilled and increased if they become so onerous that the historical consideration is no longer sufficient to depict the requirement to fulfil the liability.

BC6.22 The amortised cost basis of measurement for financial assets and financial liabilities combines information about the historical yield of financial assets and financial liabilities with updated estimates of cash flows. The Exposure Draft categorises the amortised cost basis of measurement for financial assets and financial liabilities as a historical cost measurement basis. This reflects the fact that the amortised cost of financial assets and financial liabilities is not adjusted to reflect subsequent changes in prices.

BC6.23 Paragraph 6.18 of the Exposure Draft contains a brief discussion of current cost as a measurement basis. The IASB noted that a detailed discussion of current cost would be unnecessary because the IASB would be unlikely to consider selecting current cost as a measurement basis when developing future Standards.

Current value

BC6.24 The Exposure Draft identifies current measurement bases as measures that provide monetary information about assets, liabilities, income and expenses, using information that is updated to reflect conditions at the measurement date. It goes on to describe fair value, value in use (for assets) and fulfilment value (for liabilities) as examples of current measurement bases.

BC6.25 The description of fair value in the Exposure Draft is consistent with its description in IFRS 13 *Fair Value Measurement*. The descriptions of value in use and fulfilment value are derived from the definition of entity-specific current value in IAS 16 *Property, Plant and Equipment*, which is the most explicit of the various definitions of entity-specific value in existing Standards.

BC6.26 In existing Standards, value in use is used only in determining whether an asset measured at historical cost is impaired. Within that context, when an impairment loss has been recognised on an asset, the carrying amount of the asset equals the part of historical cost that is currently recoverable. Nevertheless, the IASB proposes in the Exposure Draft to describe value in use as a separate measurement basis because:

(a) although value in use is used in determining recoverable historical cost, it differs conceptually from historical cost; and

(b) there may be situations in the future when the IASB decides that an entity should measure an asset using an entity-specific current value (ie value in use) instead of fair value.

BC6.27 The Exposure Draft explains that value in use and fulfilment value reflect the same factors in their measurement as fair value, but base those factors on entity-specific assumptions instead of assumptions by market participants.

BC6.28 Hence, value in use and fulfilment value reflect the price for bearing the uncertainty inherent in the cash flows (ie a risk premium). Including such a risk premium produces information that can be relevant, because it reflects the economic difference between items that are subject to different degrees of uncertainty. For example, the inclusion of a risk premium is already implicit in the way in which value in use is described in IAS 36 *Impairment of Assets*.

BC6.29 The Exposure Draft states that, to provide the most useful information, value in use and fulfilment value may need to be customised. In particular, the Exposure Draft notes that fulfilment value for liabilities may need to be customised so that the measure does not reflect the possibility of non-performance by the reporting entity. The IASB has found in many projects that the information provided by including non-performance risk is thought by many to be counterintuitive and not relevant. In addition, including in the measure of a liability the effect of a change in the entity's own non-performance risk may not faithfully represent the effect of the event that causes the change, because that event will probably also affect unrecognised assets (for example, unrecognised goodwill). Hence, although conceptually fulfilment value would reflect the risk of non-performance by the reporting entity, the IASB thinks that it might set Standards that would not require such risks to be reflected in an entity-specific measurement basis for a liability.

BC6.30 The Exposure Draft does not describe the following current measurement bases:[2]

(a) net realisable value. Net realisable value depicts the estimated consideration from the sale of the asset adjusted for the estimated costs

[2] The decision not to include in the Exposure Draft a detailed discussion of current cost is described in paragraph BC6.23.

of sale. The IASB believes it is unnecessary to describe net realisable value separately, because it is simply a current measure for assets that has been reduced to reflect the estimated costs of sale.

(b) cost of release. Cost of release depicts the estimated cost (including transaction costs) of obtaining release from a liability by negotiation with the counterparty. Because it is relatively unusual for entities to obtain release from liabilities, instead of fulfilling them, the IASB believes that it is unlikely that it would use this measurement basis.

Paragraphs BC6.31-BC6.40 not reproduced in this paper.

Factors to consider when selecting a measurement basis (paragraphs 6.48–6.63)

BC6.41 In order to meet the objective of financial reporting, information provided by a particular measurement basis must be useful to users of financial statements. A measurement basis achieves this if it provides information that is relevant and faithfully represents what it purports to represent. In addition, the selected measurement basis needs to provide information that is, as far as possible, comparable, verifiable, timely and understandable. The Exposure Draft discusses how these factors affect the selection of a measurement basis.

BC6.42 [not reproduced in this paper]

Relevance

BC6.43 The Exposure Draft discusses a number of factors that can affect the relevance of the information provided by a particular measurement basis:

(a) effect on both the statement of financial position and the statement(s) of financial performance (see paragraph BC6.44);

(b) contribution to future cash flows (see paragraphs BC6.45–BC6.49);

(c) an entity's business activities (see paragraphs BC6.50–6.53);

(d) characteristics of an asset or a liability (see paragraphs BC6.54–BC6.55); and

(e) measurement uncertainty (see paragraphs BC6.56–BC6.57).

Effect on both the statement of financial position and the statement(s) of financial performance

BC6.44 The Discussion Paper stated that selecting a measurement basis by considering the information that would be included in either the statement of financial position alone or the statement(s) of financial performance alone will not usually produce the most relevant information for users of financial statements. Most respondents to the Discussion Paper agreed with this suggestion. However, some suggested that the IASB should give more weight to the effect that a particular measure would have on the statement(s) of financial performance. Nevertheless, the IASB believes that the relative importance of the information produced in the statement of financial position and the statement(s) of financial performance will depend on the circumstances. Hence, the Exposure Draft carries forward the proposal in the Discussion Paper unchanged.

Contribution to future cash flows

BC6.45 The Discussion Paper suggested that the relevance of a particular measure 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 basis:

(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.

BC6.46 A few respondents disagreed with this suggestion, arguing that the IASB should adopt a single or ideal measurement basis (see paragraphs BC6.7–BC6.14). However, most of those who commented agreed with this suggestion.

BC6.47 The IASB continues to believe that the amounts included in the financial statements can be more relevant if the way in which an asset or a liability contributes to future cash flows is considered when selecting a measurement basis. Hence, this suggestion has been retained.

BC6.48 Some respondents disagreed with referring to how investors, creditors and other lenders are likely to assess how a type of asset or liability will contribute to future cash flows. They stated that preparers are unlikely to know what assessments users would make and that investors, creditors and other lenders do not have the information to assess how an asset or a liability will contribute to future cash flows. The IASB agrees with those comments. Consequently, the IASB has removed the reference to the assessments of investors, creditors and other lenders.

BC6.49 Respondents expressed concerns that the Discussion Paper contained too much Standards-level detail on the implications for subsequent measurement of how an asset or a liability contributes to future cash flows. In response, the IASB has removed much of that discussion.

An entity's business activities

BC6.50 The IASB considers that the way in which an asset or a liability contributes to future cash flows depends, in part, on the nature of the business activities being conducted. For example:

(a) non-financial assets can be sold as inventory, leased to another entity or used in the entity's business;

(b) financial assets can be held to collect cash flows or be sold;

(c) a non-financial institution will normally repay its financial liabilities in accordance with their contractual terms instead of seeking to transfer them to a third party;

(d) a financial institution is likely to seek a net cash settlement of a commodity contract (by closing out the contract) instead of receiving, and paying for, the underlying commodity; and

(e) a provider of services will normally fulfil its performance obligations by providing services instead of seeking release from the contract from its customer and instead of transferring the obligation to a third party.

BC6.51 Some respondents to the Discussion Paper feared that inconsistencies and subjectivity could result if the nature of the business activities were to be considered when selecting a measurement basis. However, the IASB believes that:

(a) 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.[3]

(b) in many cases, the nature of the business activities is a matter of fact instead of an opinion or management intent. When this is not the case, the IASB will need to consider how to address any subjectivity.

BC6.52 The Exposure Draft, therefore, states that how an asset or a liability contributes to future cash flows will depend, in part, on the nature of the business activities being conducted.

BC6.53 [not reproduced in this paper]

Characteristics of an asset or a liability

BC6.54 The Discussion Paper suggested that for some financial assets and financial liabilities (for example, derivatives), selecting a measurement basis by considering how the asset or the liability contributes to future cash flows may not provide information that is useful in assessing prospects for future cash flows. Instead, the characteristics of the asset or liability would be a key factor in selecting a measurement basis. The Discussion Paper went on to describe when cost-based information may not be useful in the case of financial assets that are held for collection or financial liabilities that are fulfilled in accordance with their terms. Although many respondents to the Discussion Paper agreed with these suggestions, some expressed the view that these were Standards-level conclusions.

BC6.55 The IASB acknowledges that the suggestion in the Discussion Paper was phrased in a way that made it look like a Standards-level decision. However,

[3] Paragraph QC23 of the *Conceptual Framework* (paragraph 2.26 of the Exposure Draft) states: ‘Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different.’

the IASB believes that underpinning the suggestion is an important idea that the characteristics of an asset or a liability are one of the factors that need to be considered when selecting a measurement basis. One example of that factor is the nature or extent of the variability in the item's cash flows or the sensitivity of the item's value to changes in market factors or to other risks inherent in the item.

Measurement uncertainty

BC6.56 Some respondents to the Discussion Paper suggested that one factor to be considered in selecting a measurement basis is the degree of measurement uncertainty associated with each measurement basis. Some respondents use the term 'reliability' to describe that factor. The IASB proposes not to reintroduce the term reliability to describe that factor. However, paragraph 2.13 of the Exposure Draft states that for some estimates, a high level of measurement uncertainty may outweigh other factors to such an extent that the resulting information may have little relevance, even is the estimate is properly described and disclosed. Consequently, the IASB believes that the level of uncertainty associated with the measurement of an item should be considered when assessing whether a particular measurement basis provides relevant information. However, it is only one of the factors that should be considered in that assessment. Sometimes a measure with a high degree of uncertainty provides the most relevant information about an item. For example, this may be the case with many financial instruments for which prices are not observable.

BC6.57 Some respondents to the Discussion Paper stated that applying prudence as they understand the term would imply that the tolerable level of measurement uncertainty would be greater for liabilities than for assets. The IASB thinks that the level of measurement uncertainty that makes information lack relevance depends on the circumstances and can only be decided when developing particular Standards. Hence, the *Conceptual Framework* neither requires nor prohibits setting different levels of tolerable measurement uncertainty for assets and liabilities.

Faithful representation (paragraph 6.57-6.58)

BC6.58 The Discussion Paper suggested that:

(a) although a faithful representation is free from error, that does not mean that measures must be perfectly accurate in all respects; and

(b) when deciding whether a particular measure faithfully represents an entity's financial position and financial performance, it may be necessary to consider how best to portray any link between items.

BC6.59 Few respondents to the Discussion Paper commented on these suggestions. The IASB still supports these suggestions and has carried them forward to the Exposure Draft.

BC6.60 A few respondents objected to the statement in the Discussion Paper that an estimate of an unobservable price can be a faithful representation if adequate disclosures are made. They agreed that an estimate of an unobservable price could be a faithful representation of that estimate. However, they argued that, if the uncertainties associated with an estimate are too large, the estimate cannot be a faithful representation of the item itself. The IASB thinks that these concerns are addressed, at least in part, by:

(a) the statement in paragraph 2.20 of the Exposure Draft (paragraph QC17 of the existing *Conceptual Framework*) that, to be useful, information must be both relevant and faithfully represented; and

(b) the discussion of the role of measurement uncertainty in selecting a measurement basis (see paragraphs BC6.56–BC6.57).

Enhancing qualitative characteristics (paragraphs 6.59–6.63)

BC6.61 The existing *Conceptual Framework* identifies four 'enhancing qualitative characteristics' that make financial information more useful: comparability, verifiability, timeliness and understandability.

BC6.62 The Discussion Paper suggested that the understandability of financial statements could be enhanced if the number of different measurement bases used is limited to the smallest number necessary to provide relevant information. Many of those who commented agreed with this suggestion.

However, some respondents disagreed, stating that there should not be an artificial limit on the number of measurement bases used. In their view, a different measurement basis should be selected if it will provide relevant information to the users of financial statements.

BC6.63 It was not the IASB's intention to impose an artificial limit on the number of measurement bases used. A different measurement basis should be used if it will provide the most relevant information to users of financial statements. Hence, the IASB has replaced the statement that the number of different measurement bases used should be limited to the smallest number necessary with a discussion on the advantages and disadvantages of introducing new or different measurement bases.

BC6.64 The Discussion Paper also suggested that the understandability of financial statements would be enhanced by avoiding unnecessary changes in measurement bases and by explaining necessary changes. Most respondents who commented agreed with this suggestion. The Exposure Draft retains that discussion and clarifies that avoiding unnecessary measurement changes does not preclude:

(a) current values being used as a deemed cost on initial measurement (see paragraph 6.11 of the Exposure Draft); or

(b) a change in measurement basis to enhance the relevance of the information provided (see paragraph 6.63 of the Exposure Draft).

BC6.65 The Discussion Paper also discussed the implications of the enhancing qualitative characteristics of timeliness, verifiability and comparability for measurement. Few respondents commented on this discussion. Those commenting suggested that:

(a) verifiability has a significant role to play in the selection of a measurement basis; and

(b) comparability could be enhanced by removing the ability for preparers to choose between measurement bases.

BC6.66 The IASB believes that the discussion of verifiability in the Discussion Paper appropriately reflected the importance of verifiability as one of the factors that should be considered when selecting a measurement basis. In addition, paragraph 2.28 of the Exposure Draft (paragraph QC25 of the existing *Conceptual Framework*) already acknowledges that permitting alternative accounting methods for the same economic phenomenon diminishes comparability. Consequently, the Exposure Draft includes the discussion of verifiability and comparability suggested in the Discussion Paper, largely unchanged. The IASB considers that the enhancing qualitative characteristic of timeliness has few implications for the selection of a measurement basis.

Paragraphs BC6.67-BC6.69 not reproduced in this paper.