STAFF PAPER

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ASAF meeting

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

1. At the Accounting Standards Advisory Forum (ASAF) meeting in March 2015, you discussed the description of the measurement bases proposed in the IASB's Exposure Draft *Conceptual Framework for Financial Reporting* (the 'Exposure Draft'). At this meeting we would like to get your feedback on the proposed guidance on factors to consider when selecting a measurement basis. This discussion will build on the discussions at the World Standard-setters meeting on 29 September 2015.

2. In addition, we would like your feedback on the Exposure Draft discussion of situations in which more than one measurement basis is needed to provide relevant information about an item.

3. This paper provides the basis for the discussion at this meeting. Specifically, this paper:
   (a) sets out the questions for the members of the ASAF (paragraph 4); and
   (b) includes as appendices the measurement chapter of the Exposure Draft (see Appendix A) and the Basis for Conclusions on that chapter (see Appendix B).

Questions for the members of ASAF

4. During this meeting we would like to get your feedback on the following questions:

Question 1—Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis (paragraphs 6.48–6.73)? If not, what factors would you consider and why?

Question 2—More than one relevant measurement basis
Do you agree with the approach discussed in paragraphs 6.74–6.77 and BC6.68? Why or why not?

Appendix A –Exposure Draft

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Chapter 6—Measurement

Introduction

6.1 This chapter discusses:

(a) measurement bases and the information that they provide (paragraphs 6.4–6.47);

(b) factors to consider when selecting a measurement basis (paragraphs 6.48–6.73).

(c) situations when more than one measurement basis provides relevant information (paragraphs 6.74–6.77); and

(d) measurement of equity (paragraphs 6.78–6.80).

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. Paragraphs 6.78–6.80 discuss the measurement of equity.

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 Paragraphs A1–A10 discuss cash-flow-based measurement techniques. These techniques are often used to estimate a measure on a particular measurement basis.

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) for that asset (liability).

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, following paragraph 6.47. Paragraphs 6.13–6.17 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 As noted in paragraph 6.11, 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 The fair value of:

(a) an asset is not increased by the transaction costs incurred when acquiring the asset. Nor is it decreased by the transaction costs that would be incurred on selling the asset.

(b) a liability is not decreased by the transaction costs arising when the liability is incurred. Nor is it increased by the transaction costs that would be incurred on transferring or settling the liability.

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 following paragraph 6.47. Paragraphs 6.28–6.33 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 participants' 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 fulfils 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, following paragraph 6.47. 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 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.

Summary of information provided by different measurement bases

6.47 Table 6.1 summarises the information provided in the statement of financial position and the statement(s) of financial performance by the measurement bases described in paragraphs 6.6–6.46.

Table 6.1—Information provided by various measurement bases

Assets

	Historical cost measures	Current value measures	
		Fair value (market participant assumptions)	**Value in use (entity-specific assumptions)**
Statement of financial position	Recoverable cost of the unconsumed (or uncollected) part of an asset (includes transaction costs incurred on acquisition).	Price that would be received to transfer the asset.	Present value of cash flows estimated to arise from the continuing use of the asset and from its disposal at the end of its useful life (includes present value of future costs of transfer).
Statement(s) of financial performance[(a),(b)]	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.
	–	Transaction costs on acquiring the asset.	Transaction costs on acquiring the asset.
	Historical cost of the economic resources consumed in the period (through cost of sales, depreciation or amortisation, etc).	Fair value, at the time of consumption, of economic resources consumed during the period.	Value in use, at the time of performance, of economic resources consumed during the period.
	Interest income (financial assets only).	Interest income (if identified separately).	Interest income (if identified separately).
	Impairment losses (compared with previous historical cost).	Impairment losses (if identified separately).	Impairment losses (if identified separately).
	Income or expenses on sales of assets during the period (includes transaction costs incurred then, which may or may not be identified separately).	Transaction costs incurred on disposal. Also, net income (or net expense) if consideration received exceeds (or is less than) the fair value at the date of disposal.	Transaction costs incurred on disposal. Also, net income (or net expense) if consideration received exceeds (or is less than) the value in use at the date of disposal.
	–	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.

(a) Not all items will arise in every period.

(b) Chapter 7 discusses the presentation and disclosure of items of income or expense in the statement(s) of financial performance.

Table 6.1 continued

Liabilities

	Historical cost measures	**Current value measures**	
		Fair value (market participant assumptions)	**Fulfilment value (entity-specific assumptions)**
Statement of financial position	Net consideration for taking on the unfulfilled part of a liability, plus any excess of the present value of the estimated cash flows over that net consideration (consideration is net of the transaction costs).	Price that would be paid to transfer the liability.	Present value of cash flows estimated to arise in fulfilling the liability.
Statement(s) of financial performance[(a),(b)]	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.	Income or expenses on initial recognition of exchanges of unequal value.
	–	Transaction costs on incurring the liability.	Transaction costs on incurring the liability.
	Consideration provided by customers (or others) for obligations fulfilled by the entity during the period.	Fair value, at the time of performance, of performance obligations fulfilled by the entity during the period.	Fulfilment value, at the time of performance, of performance obligations fulfilled by the entity during the period.
	Interest expenses.	Interest expenses (if identified separately).	Interest expenses.
	Losses on liabilities that have become (more) onerous during the period.	Losses on liabilities that have become (more) onerous during the period (if identified separately).	Losses on liabilities that have become (more) onerous during the period (if identified separately).
	Income and expenses on settlement or transfers of liabilities in the period (includes transaction costs incurred then, which may or may not be identified separately).	Transaction costs incurred on settlement or transfer. Also, net expense (or net income) if consideration paid exceeds (or is less than) the fair value at the date of settlement or transfer.	Transaction costs incurred on settlement or transfer. Also, net expense (or net income) if consideration paid exceeds (or is less than) the fulfilment value at the date of settlement or transfer.
	–	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.	Remeasurement caused by: (a) changes in estimates of cash flows; (b) changes in interest rates; and (c) changes in the amount of risk or in its price.

(a) Not all items will arise in every period.

(b) Chapter 7 discusses the presentation and disclosure of items of income or expense in the statement(s) of financial performance.

Factors to consider when selecting a measurement basis

6.48 The discussion in paragraphs 6.4–6.47 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 Measures of assets, liabilities, income and expenses are used in the measurement of recognised items, and in presentation and disclosure. The following discussion on the factors to be considered in selecting a measurement basis focuses on the selection for recognised items. Nevertheless, some of that discussion may also apply to the disclosure in the notes to the financial statements of measures of unrecognised assets and unrecognised liabilities.

6.52 Paragraphs 6.53–6.63 discuss the factors to be considered in selecting a measurement basis by reference to the qualitative characteristics of useful financial information. Paragraphs 6.64–6.73 discuss additional factors to consider in selecting a measurement basis on initial recognition. Initial measurement and subsequent measurement cannot be considered separately. If the initial measurement basis and subsequent measurement basis are not consistent, income and expenses will be recognised solely because of the change in measurement basis. Recognising such income or expenses might appear to depict a transaction or other event when, in fact, no such transaction or event has occurred. Hence, the choice of measurement basis for an asset or a liability and the related income or expenses is determined by considering both the initial measurement and the subsequent measurement.

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 (see paragraphs 2.12–2.13). 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 (see paragraph 5.13).

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 As noted in paragraphs 2.15 and 2.19, 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 expenses recognised as a result of the change in measurement basis.

Factors specific to initial measurement

6.64 Paragraphs 6.48–6.63 discuss factors to consider when selecting a measurement basis, whether at initial recognition or subsequently. The following paragraphs discuss some additional factors to consider solely at initial recognition.

6.65 Assets and liabilities may be recognised initially as a result of:

(a) exchanges of items of similar value (see paragraphs 6.66–6.68);

(b) transactions with holders of equity claims (see paragraph 6.69);

(c) exchanges of items of different value (see paragraphs 6.70–6.71); or

(d) internal construction of an asset (see paragraphs 6.72–6.73).Paragraphs 6.48–6.63 discuss factors to consider when selecting a measurement basis, whether at initial recognition or subsequently. The following paragraphs discuss some additional factors to consider solely at initial recognition.

Exchanges of items of similar value

6.66 An exchange of items of similar value might occur:

(a) when an entity acquires an asset in exchange for incurring a liability. The asset and the liability are normally measured initially at the same amount. Thus, no income or expenses are recognised as a result of that transaction, except when the transaction costs are not included in the initial measure of the asset or the liability.

(b) when an entity acquires an asset, or incurs a liability, in exchange for transferring another asset or liability. The initial measure of the asset acquired (or the liability incurred) determines whether any income or expenses arise on the transfer of the other asset or the liability.

6.67 At initial recognition, the cost of an asset or a liability is normally similar to its fair value at that date, except if transaction costs are material. Nevertheless, even if those two amounts are similar, it is necessary to describe what measurement basis is used at initial recognition. If historical cost will be used subsequently, that basis is also normally appropriate at initial recognition. Similarly, if a current value will be used subsequently, it is also normally appropriate at initial measurement, thus avoiding an unnecessary change at the first subsequent measurement (see paragraph 6.63).

6.68 In some cases, the initial measure of one of the items exchanged may need to be used as the deemed cost of the other item. Paragraph 6.11 discusses deemed cost.

Transactions with holders of equity claims

6.69 If an entity receives an asset from a holder of an existing or new equity claim, it would normally be appropriate:

(a) to measure the asset initially at a current value. If the asset will be measured subsequently at historical cost, the current value would form the deemed cost of the asset at that date.

(b) to recognise a contribution from the holders of equity claims, after deducting the current value of consideration provided to them, if any.

Exchanges of items of different values

6.70 Sometimes, two items of different value are exchanged; for example, because the transaction price is affected by relationships between the parties or by financial distress or other duress of one of the parties. In such cases, measuring the asset acquired, or the liability incurred, at historical cost may not faithfully represent income or expenses (for example, a loss arising from an overpayment or a gain arising from a bargain purchase).

6.71 On other occasions, an asset is acquired, or a liability is incurred, for no consideration; for example, when an asset is acquired as a gift or when a liability to pay compensation or penalties arises from an act of wrongdoing. In such cases, measuring the asset acquired, or the liability incurred, at its historical cost of zero would be unlikely to provide a faithful representation of the assets and liabilities of the entity. Hence, it may be appropriate to measure such assets and liabilities at a current value and recognise the difference as income or expense.

Internally constructed assets

6.72 Unnecessary changes in measurement bases can be avoided by measuring assets constructed by the entity on the same basis as the basis that would be used subsequently (for example, at historical cost if the subsequent measurement of the asset will be historical cost and at current value if the subsequent measurement of the asset will be a current value).

6.73 Measuring the asset on its completion date at a fair value could provide relevant information about the cost-effectiveness of the construction through the recognition of income or expenses on completion. Hence, a change in the measurement basis from historical cost to fair value may be justified. However, determining fair value may not be easy for unique or custom-made assets. Consequently, the cost of doing so may outweigh the benefits for many internally constructed assets.

More than one relevant measurement basis

6.74 Sometimes, more than one measurement basis is needed to provide relevant information about an asset, liability, income or expense.

6.75 In most cases, the most understandable way to provide that information is:

(a) to use a single measurement basis for the asset or the liability both in the statement of financial position and for related income and expenses in the statement(s) of financial performance; and

(b) to disclose in the notes to the financial statements additional information using the other measurement basis.

6.76 However, in some cases, because of the way in which an asset or a liability contributes to future cash flows (which depends in part on the nature of the business activities conducted by the entity) or because of the characteristics of the asset or the liability, the information provided in the statement of financial position and the statement(s) of financial performance is made more relevant by using:

(a) a current value measurement basis for the asset or the liability in the statement of financial position; and

(b) a different measurement basis to determine the related income or expenses in the statement of profit or loss (see paragraph 7.25).

6.77 In such cases, the total income or total expenses arising from the change in the current value in the statement of financial position is split into two components:

(a) in the statement of profit or loss: the income or expenses measured using the measurement basis selected for that statement; and

(b) in other comprehensive income (see paragraph 7.19): the remaining income or expenses. The cumulative income or expenses included in other comprehensive income equals the difference between the carrying amount determined by the measurement basis selected for the statement of financial position and the carrying amount determined by the measurement basis selected in determining profit or loss.

Measurement of equity

6.78 The total amount at which equity is shown in the statement of financial position (total equity) is not measured directly; instead, it equals the total of the carrying amounts of all recognised assets less the total of the carrying amounts of all recognised liabilities.

6.79 Because general purpose financial statements are not designed to show an entity's value, total equity will not generally equal:

(a) the aggregate market value of the entity's shares;

(b) the sum that could be raised by selling the entity as a whole on a going concern basis; or

(c) the sum that could be raised by selling all its assets after settling all its liabilities.

6.80 Although total equity is not measured directly, some individual classes or categories of equity may be measured directly. The total amount attributed to individual classes or categories of equity may be positive or, in some circumstances, negative. Similarly, although total equity is generally positive, it can also be negative, depending on which assets and liabilities are recognised and on how they are measured.

Appendix B –Basis for Conclusions

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Basis for Conclusions

BC6.1 The existing *Conceptual Framework* provides very little guidance on measurement. The Discussion Paper discussed:

(d) how the objective of financial reporting and qualitative characteristics of useful financial information influence measurement requirements;

(e) three categories of measurement bases; and

(f) how to identify an appropriate measurement basis and the implications of the proposed approach for particular types of assets and liabilities.

BC6.2 Many respondents agreed with the overall approach to measurement suggested in the Discussion Paper. Their comments on particular aspects of that approach are discussed in the following paragraphs. However, some respondents suggested that the IASB should undertake further research on measurement and either:

(a) delay issuing a revised Conceptual Framework until that research is completed;

(b) issue a revised Conceptual Framework without a measurement section; or

(c) develop high level interim guidance on measurement for use until rigorous concepts and principles can be developed.

BC6.3 The lack of guidance on measurement is a serious gap in the existing *Conceptual Framework* and many respondents to the Discussion Paper broadly supported the suggested approach to measurement. Moreover, the IASB believes that it is not necessary or appropriate to delay all or part of the *Conceptual Framework* to undertake more research on measurement. The IASB also does not support the idea of issuing high level interim guidance. High level guidance may not be sufficient to help the IASB develop measurement requirements and could be in place for a long time.

BC6.4 Some respondents expressed the view that the measurement section of the Discussion Paper contained too much Standards-level detail. The IASB agrees with them and has removed some of that detail.

BC6.5 Accordingly, Chapter 6 of the Exposure Draft focuses on:

(a) measurement bases, the information they provide and their advantages and disadvantages (paragraphs BC6.15–BC6.37); and

(b) the factors to consider when selecting a measurement basis (paragraphs BC6.41–BC6.68).

BC6.6 Paragraphs BC6.7–BC6.14 discuss the mixed measurement basis approach proposed in the Exposure Draft.

Mixed measurement basis (paragraph 6.3)

BC6.7 When developing both the Discussion Paper 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)).

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 6.4–6.47)

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–BC6.30 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. Paragraphs BC6.31–BC6.33 discuss those techniques.

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, which are discussed in paragraphs BC6.34–BC6.37.

(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. The proposed guidance on this topic is discussed in paragraphs BC6.34–BC6.37.

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*.[1]

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

1 See paragraphs 55–56, A1 and A15–A21 of IAS 36.

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 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.

Cash-flow-based measurement techniques (paragraphs 6.5 and A1–A10)

BC6.31 As explained in paragraph BC6.17(b), cash-flow-based measurement techniques are techniques used in applying a defined measurement basis. The Exposure Draft includes a brief discussion of these techniques in Appendix A.

BC6.32 The Discussion Paper discussed factors to consider when developing cash-flow-based measures. A few respondents suggested expanding this discussion to provide the IASB with more guidance on:

(a) the use and determination of discount rates. As part of its research programme, the IASB is at present gathering evidence to help it

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

assess whether to take on a project to develop guidance on the use and determination of discount rates.[3]

(b) whether the effect of changes in own credit risk should be included in a cash-flow-based measure (see paragraph BC6.29).

(c) approaches to dealing with uncertain cash flows (for example, using the mean, median or mode of a cash flow distribution, and the inclusion and calculation of a risk adjustment). Paragraphs A6–A10 of the Exposure Draft include a discussion of these approaches.

BC6.33 The Exposure Draft notes that cash-flow-based measurement techniques can be used to customise measurement bases. Customising measurement bases could result in more relevant information for users of financial statements, but the resulting information may also be more difficult for users to understand. Hence, if the IASB decides to use a customised measurement basis, the Basis for Conclusions on the relevant Standard will explain the reasons for that decision.

Transaction costs (paragraphs 6.7–6.9, 6.26 and 6.37–6.38)

BC6.34 Transaction costs can arise both when an asset (liability) is acquired (incurred) and when an asset (liability) is realised (settled or transferred). Defining which costs are transaction costs is beyond the scope of the *Conceptual Framework*. They are normally defined in particular Standards as incremental costs (other than the transaction price) that would not have been incurred if the particular asset (or liability) being measured had not been acquired (incurred) or realised (transferred or settled). The IASB frequently discusses the treatment of transaction costs when it discusses the measurement requirements for new or revised Standards. Consequently, the Exposure Draft proposes guidance on the treatment of transaction costs.

3 For the IASB to add a project to its active agenda, a formal agenda decision would be required.

BC6.35 Transaction costs incurred in acquiring an asset or taking on a liability are a feature of the original transaction in which the asset was acquired or the liability was incurred. Hence:

(a) the cost of an asset or a liability reflects (among other things) the transaction costs of acquiring the asset or incurring the liability. Although the transaction costs are not part of the transaction price, the asset could not have been acquired or the liability incurred without incurring those transaction costs.

(b) if a measure is intended to depict the fair value, fulfilment value or value in use of an asset or a liability, the measure would not reflect those transaction costs. Those costs do not affect the current value of that asset or liability.

BC6.36 Transaction costs that would be incurred in realising an asset, or settling or transferring a liability, are a feature of a possible future transaction. Hence:

(a) because value in use depicts the present value of the cash flows that are estimated to arise from the continued use of the asset and from its disposal at the end of its useful life, estimated transaction costs on that disposal are deducted in arriving at those cash flows. Similarly, because fulfilment value depicts the present value of the cash flows needed to fulfil a liability, the transaction costs (if any) of fulfilment are included in those cash flows. As implied by their definitions, both value in use and fulfilment value reflect the present value of those cash flows.

(b) it would be inconsistent with historical cost measurement to reduce (increase) the cost-based measure of an asset (liability) to reflect transaction costs that will arise only if a future transaction occurs (historical cost uses information about past transactions). However, the transaction costs that would be incurred in realising an asset (or settling or transferring a liability) may become relevant in determining whether the asset is impaired (or whether the liability has become onerous) or in determining the residual value of an asset for depreciation purposes.

BC6.37 A fair value measure depicts 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. Because the costs to sell an asset (or transfer a liability) are not part of the price of the asset (or liability) that is being sold or transferred, they are not included in a fair value measure. However, this does not preclude the IASB from deciding that an entity should measure an asset at fair value less costs to sell (or a liability at fair value plus costs of transfer).

Objective of measurement (paragraphs 6.2 and 6.49)

BC6.38 The Discussion Paper suggested that the objective of measurement is to contribute to the faithful representation of relevant information about:

(a) the resources of the entity, claims against the entity and changes in resources and claims; and

(b) how efficiently and effectively the entity's management and governing body have discharged their responsibilities to use the entity's resources.

BC6.39 Although many respondents to the Discussion Paper agreed with that suggested objective, some stated that it simply repeats the objective of financial reporting and the qualitative characteristics of useful information. Consequently, these respondents believe that the suggested objective would not provide useful guidance to the IASB in setting measurement requirements.

BC6.40 The IASB agrees with these comments, but believes that it is important to provide a link between measurement and the objective of financial reporting. Hence, the Exposure Draft does not define an objective for measurement. Instead, it describes the measurement process (see paragraph 6.2 of the Exposure Draft) and the factors to consider when selecting a measurement basis in order to contribute to the overall objective of financial reporting (see paragraph 6.49 of the Exposure Draft).

Factors to consider when selecting a measurement basis (paragraphs 6.48–6.73)

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 Paragraph BC2.33 explains why there is an explicit reference to the cost constraint in the chapter on measurement.

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–BC6.53);

(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 suggestion made 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.[4]

(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 Some respondents to the Discussion Paper argued that the IASB should identify long-term investment as a particular type of business activity and develop specific measurement requirements for entities conducting that business activity. However, the IASB believes that the *Conceptual Framework* need not (and should not) refer explicitly to any particular business activity, such as long-term investment, for the reasons set out in paragraphs BCIN.35–BCIN.38.

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.

4 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.'

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, 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. For reasons noted in paragraphs BC2.21–BC2.25, 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 if 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 (see paragraphs BC2.1–BC2.15). 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 (paragraphs 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 (in paragraph 6.62 of the Exposure Draft) 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.

Factors to consider on initial recognition (paragraphs 6.64–6.73)

BC6.67 The Discussion Paper included a discussion on factors to consider when deciding how to measure an asset or a liability on initial recognition. Few respondents commented on that discussion. However, a few stated that the discussion was too prescriptive for the *Conceptual Framework.* In response, the IASB has shortened that discussion and removed some Standards-level detail.

More than one relevant measurement basis (paragraphs 6.74–6.77)

BC6.68 The IASB considers that, in some cases, consideration of the objective of financial reporting, and of the qualitative characteristics of useful financial information, will indicate that using more than one measurement basis for the same item in the same financial statements could provide useful information to the users of financial statements. Hence, the Exposure Draft discusses how information about more than one measurement basis could be provided.

Measurement of equity (paragraphs 6.78–6.80)

BC6.69 Although total equity is not measured directly, the IASB considers that, in order to provide useful information, it may be necessary to measure directly individual classes or categories of equity. Hence, the Exposure Draft discusses this notion.