STAFF PAPER

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Project	Conceptual Framework		
Paper topic	Applying the proposed measurement guidance		
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Purpose of this breakout session

1. The purpose of this breakout session is to get your feedback on how useful the proposed guidance in the *Conceptual Framework* Exposure Draft on selection of a measurement basis will be for future standard-setting.

2. During this session we will ask you to apply the proposed guidance to the assets and liabilities described on page 8. As you apply the proposed guidance, we would like you to focus on the following questions:

Questions

1) Does the proposed guidance on factors to consider when selecting a measurement basis (see paragraphs 9—10) help you to make decisions about how the assets and liabilities described on page 8 should be measured? Why or why not?

2) Could any of the factors be excluded? Are there any additional factors that the IASB should consider when selecting a measurement basis?

3) Do the tables summarising the information provided by each of the measurement bases (see paragraph 8) help you to make decisions about how the assets and liabilities described on page 8 should be measured? Why or why not?

3. You will have approximately 1 hour to complete the task. At the end of the hour, a plenary session will be held at which the Chair of each breakout group will provide a 10 minute summary of the discussion.

4. In the rest of this paper we:

   (a) summarise the guidance on selection of a measurement basis proposed in the *Conceptual Framework* Exposure Draft including a summary of the information provided by the identified measurement bases and the factors to be considered when selecting a measurement basis (paragraphs 6—10); and

   (b) describe the assets and liabilities to which we would like you to apply the proposed guidance (paragraphs 11—12).

5. The appendix to this paper reproduces the measurement Chapter of the *Conceptual Framework* Exposure Draft.

Proposed guidance on selection of a measurement basis

6. The *Conceptual Framework* Exposure Draft identifies the following measurement bases:

   (a) Historical cost, which includes amortised cost of financial assets and financial liabilities.

   (b) Current value. Current values are subdivided into:

      (i) current values based on market participant assumptions (fair value);

      (ii) current values based on entity-specific assumptions (value in use for assets and fulfilment value for liabilities).

7. To help the IASB select a measurement basis, the *Conceptual Framework* Exposure Draft:

   (a) summarises the information provided by the identified measurement bases (paragraph 8);

   (b) describes the factors to be considered when selecting a measurement basis (paragraphs 9—10).

Information provided by the identified measurement bases

8. The following tables, which are taken from Chapter 6 (Measurement) of the *Conceptual Framework* Exposure Draft, are intended to help the IASB select a measurement basis. The tables summarise the information provided by the identified measurement bases in both the statement of financial position and the statement(s) of financial performance:

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.

	Historical cost measures	Current value measures	
		Fair value (market participant assumptions)	Value in use (entity-specific assumptions)
	–	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.

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

9. The *Conceptual Framework* Exposure Draft states that if information provided by a particular measurement basis is to be useful to the users of financial statements:

   (a) it must be **relevant**;

   (b) it must **faithfully represent** what it purports to represent;

   (c) it should maximise, as far as possible, the **enhancing qualitative characteristics** of comparability, verifiability, timeliness and understandability.

   (d) the benefits of the information provided must be sufficient to justify the costs of providing that information.

10. The Exposure Draft identifies the following specific factors to be considered when selecting a measurement basis (see Appendix paragraphs 6.48—6.63 for a more detailed discussion of these factors):

    Relevance

    (a) The information that the measurement basis will produce in both the statement of financial position and the statement(s) of financial performance.

    (b) How the asset or liability contributes to future cash flows. This will depend in part on the nature of the business activities conducted by the entity.

    (c) The characteristics of the asset or 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).

    (d) The level of measurement uncertainty in estimates of the measure.

    Faithful representation

    (e) Any linkage between assets and liabilities (for example, contractual links).

Enhancing qualitative characteristics

(f) Comparability of the measurement basis between periods and between entities.

(g) Verifiability of the measurement basis.

(h) Understandability – the use of new or different measurement bases must be justified and unnecessary changes in measurement bases should be avoided.

Assets and liabilities

11. Using the summary of the information provided by the different measurement bases and the proposed factors, we would like you to select a measurement basis for the assets and liabilities described in the table on page 8.

12. The *Conceptual Framework* Exposure Draft acknowledges that in some situations the IASB may choose to customise one of the identified measurement bases (for, example, the IASB may decide to exclude the effects of changes in own credit from the fulfilment value of some liabilities). If you believe that the measurement basis used should be customised for one or more of the assets or liabilities described in the table on page 8, please be prepared to explain how that measurement should be customised, and why.

Type of asset or liability	Measurement basis?			Customise?
	Historical cost	Current value		
		Fair value	Value in use/ Fulfilment value	
Inventory (not commodity-broker traders)				
Building (own use)				
Investment property				
Equity investment (no active market)				
Performance obligation arising from a contract with a customer				
Interest bearing financial liability (not traded)				
Decommissioning liability				

Appendix

This appendix reproduces Chapter 6—Measurement of the *Conceptual Framework* Exposure Draft.

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

[Table 6.1 is reproduced after paragraph 8 of this paper]

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).

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.