

## STAFF PAPER

April 2016

## IASB Meeting

Project	Conceptual Framework		
Paper topic	Approach to redeliberations—Measurement		
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**Purpose of paper**

1. This paper seeks your views on our proposed approach to the redeliberations of the Measurement chapter of the Exposure Draft *Conceptual Framework for Financial Reporting* (‘the Exposure Draft’).
2. This paper is structured as follows. The next section (paragraph 7) provides background. The following three sections discuss different approaches that might be adopted in the revision of the Measurement chapter. All of these approaches are based on the assumption that a revised *Conceptual Framework* will be published early in 2017.
3. The approaches are:
  - (a) **Approach A—Discard** the Measurement chapter in the Exposure Draft and undertake a research project, with the aim of completing the *Conceptual Framework* when that work is concluded (paragraphs 8–10);
  - (b) **Approach B—Retain** the Measurement chapter, making only minor changes (paragraphs 11–13); and
  - (c) **Approach C—Build** on the Measurement chapter, retaining many of its ideas and making the links between the ideas discussed clearer, and making the implications of the discussion evident (paragraphs 14–19).
4. These three approaches are identified to assist in structuring the Board’s discussion. It is not intended to suggest that they represent the only possible approaches. It is acknowledged that the strategy will need to be reviewed and so may change. The aim of the discussion is not to

commit us to a definite destination: rather it is to decide on a direction in which to make a start.

5. A staff recommendation and a question for the Board are set out in the final section (paragraphs 20–24).

### **Summary of staff recommendation**

6. The staff recommend that the Measurement chapter should initially be developed using Approach C—the build approach. This retains the insights gained in developing the Exposure Draft and the preceding Discussion Paper, and allows consideration of possible improvements that might be reflected in the revised *Conceptual Framework*.

### **Background**

7. The Board discussed a summary of the responses to the Measurement chapter at its March meeting ([Agenda Paper 10I](#)). At that meeting it was reported that:
  - (a) Many respondents to the Exposure Draft either expressed significant reservations about the Measurement chapter or expressed the view that it did not provide an adequate foundation to support the development of accounting Standards. Respondents that expressed significant concerns included many (more than half) of the standard-setters that responded, and some accountancy bodies and accounting firms; representative bodies of preparers and users; and regulators.
  - (b) Some respondents suggested that further research was necessary before the Measurement chapter was issued. Others suggested that the *Conceptual Framework* should be issued with only limited guidance on measurement, with further research being undertaken subsequently.
  - (c) Of those that addressed the issue, most respondents showed considerable support for the measurement bases that were discussed in the Exposure Draft, and for the idea that consideration of the objective of financial reporting, and the qualitative characteristics 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.

- (d) Some respondents considered that additional measurement bases should be addressed, and that aspects of measurement bases such as entry/exit values and entity-specific and non-entity-specific values should be considered.
- (e) Although most respondents that expressed a view agreed that principles for selecting a measurement basis should be based on the qualitative characteristics of useful financial information, some considered that the guidance proposed does not provide an adequate basis for the development of accounting Standards.
- (f) Some respondents specifically supported the suggestion that ‘how an asset or liability contributes to future cash flows which depends, in part, on its business activities’ is an important factor to consider in selecting a measurement basis. Many of these supported the reference to ‘business activities’ and suggested that the reference should be more prominent or even be the paramount factor. However, some suggested that the idea of ‘business activities’ should be subsidiary to other factors in some cases; others were concerned that an emphasis on ‘business activities’ would lead to a loss of comparability.
- (g) Many respondents agreed with the proposal that where a current measurement basis is used in the statement of financial position, a different measurement basis may be used in the statement of profit or loss. However, some considered that further guidance or a clearer conceptual basis for this is necessary.

## **Approach A—Discard the measurement chapter**

### ***Description of the discard approach***

8. The discard approach suggests that the Measurement chapter in the Exposure Draft should be discarded. The revised *Conceptual Framework* would be issued without a measurement chapter, and the Board would undertake a research project on measurement, with the aim of completing the *Conceptual Framework* when that work is concluded.

***Advantages of the discard approach***

9. The advantages of the discard approach include:
- (a) It allows the Board to carry out further research and thinking about measurement issues before committing itself to a particular approach.
  - (b) It would ensure that the issue of the revised *Conceptual Framework* was not impeded by the need to consider measurement issues.

***Disadvantages of the discard approach***

10. The disadvantages of the discard approach include:
- (a) The revised *Conceptual Framework* would be issued without achieving one of the main objectives of the project—to complete gaps in the existing *Conceptual Framework*.
  - (b) The *Conceptual Framework* would not provide any guidance to the Board in developing Standards until the research was completed, which would probably be a considerable period. (The research would presumably require publication of a Discussion Paper, followed by an Exposure Draft of proposed changes to the *Conceptual Framework*.) This would seem to be particularly regrettable given that, as summarised in paragraph 7 above, although many respondents thought the Measurement chapter needed improvement, they agreed with some of the key proposals.
  - (c) The research might not produce any consensus on the approach to be adopted. Approaches to measurement have been debated for many years, both in the academic literature and by standard-setters, and little agreement has been reached.

**Approach B—Retain the Measurement chapter, with only minor changes**

***Description of the retain approach***

11. The retain approach suggests that the measurement chapter in the Exposure Draft should be retained with only minor changes. The changes would presumably mostly be on points raised by the respondents to the Exposure Draft. Issues that might be reconsidered include:

- (a) the discussion, within the context of historical cost, of impairment, amortised cost and current cost;
- (b) the treatment of transaction costs;
- (c) the tabular presentation of information provided by the various measurement bases;
- (d) the relationship between initial and subsequent measurement; and
- (e) transactions that are not on arms-length terms.

### ***Advantages of the retain approach***

12. The advantages of the retain approach include:
- (a) It could be completed relatively speedily and would be unlikely to delay the issue of a revised *Conceptual Framework*.
  - (b) The *Conceptual Framework* would provide some guidance to assist the Board in the development of accounting Standards.
  - (c) It would not preclude the Board from carrying out further research on measurement, which might result in future proposals for revisions to the *Conceptual Framework*.

### ***Disadvantages of the retain approach***

13. The disadvantages of the retain approach include:
- (a) It would not respond to the comments of respondents on the Exposure Draft.
  - (b) The opportunity to consider potential improvements would be missed. There may be some merit in respondents' observations that the existing chapter is inadequate for providing guidance to the Board on the development of accounting Standards.
  - (c) The revised chapter might entrench views that are inconsistent with any further research or insights gained from the development of Standards.

## **Approach C—Build on the Measurement chapter**

### ***Description of the build approach***

14. The build approach attempts to develop an improved text of the Measurement chapter. The aim would be to retain many of the ideas that were set out in the Exposure Draft, while clarifying the links between the ideas discussed and the implications of the discussion. More specifically, the aim would be to clarify the description of measurement bases, the information they provide and the factors to be considered in the selection of a measurement basis. This might involve the development of some new material.
15. The build approach recognises that respondents to the Exposure Draft broadly supported:
  - (a) the suggestion that it was likely that (having regard to the objective of financial reporting and the qualitative characteristics) different measurement bases would be selected for different assets, liabilities, income and expenses;
  - (b) the categorisation of measurement bases into two broad classes: cost and current values; and
  - (c) the factors to consider in selecting a measurement basis, particularly the contribution of an asset or liability to cash flows or business activities.
16. If it is decided to adopt the build approach, the staff will develop a detailed plan for its implementation. The following simply indicates some of the changes that might be considered:
  - (a) an expanded introduction to the chapter, explaining the measurement process, and how it relates to the objective of financial reporting and the qualitative characteristics. This could include an explanation of the significance of amounts reported in both the statement of financial position and the statement(s) of financial performance.
  - (b) an expanded discussion of historical cost, its rationale, advantages and disadvantages.
  - (c) a fuller discussion of current cost. This might discuss the view that, in order to provide useful information in the statements(s) of financial performance, holding gains and losses and cost of consumption should be reported separately where current cost measurement is used.

- (d) a discussion of factors that would suggest how a selection might be made between historical and current cost. These include the prevalence of price changes (eg long production cycles, sensitivity to market changes), availability of information, cost and complexity. We might also consider the issue of reporting assets, liabilities income and expense at different cost measures.
- (e) continued discussion of forward-looking current value measures (fair value and value in use/fulfilment value).
- (f) building on the idea that an important factor in the choice between a cost-based measure and a current value will often be the contribution that the asset or liability makes to future cash flows. The essential idea is that cost measures (which are entry values) are likely to be more relevant for assets such as property, plant and equipment and inventory that are used within a business, while current values (mainly exit values) are more likely to be relevant for assets (liabilities) that will or may be sold (transferred). There are various ways in which the rationale for this might be expressed:
  - (i) Cost measures should be preferred until any increase value is irreversible (or deemed irreversible).
  - (ii) Cost measures should be preferred where there are impediments, including economic disincentives, to sell or transfer an asset or liability.
  - (iii) Cost measures should be preferred for assets and liabilities in a ‘value added’ business activity, whilst current measures are more relevant for those held in a ‘price change’ business activity.
  - (iv) An in-use valuation premise (not to be confused with value in use as a measurement basis) versus an exchange valuation premise.

17. There is much similarity and overlap between the notions listed in paragraph 16(f) (although there are also some differences). Those listed at (i)–(iii) have been advocated in papers presented at the Accounting Standards Advisory Forum (ASAF)<sup>1</sup> while the in-use versus in

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<sup>1</sup> ASAF meetings December 2013 (Agenda Paper 3); March 2014 (Agenda Paper 5A); June 2014 (Agenda Paper 6).

exchange distinction was advocated in a recent paper co-authored by Christine A. Botosan<sup>2</sup>, who has recently been appointed to the Financial Accounting Standards Board.

### ***Advantages of the build approach***

18. The advantages of the build approach include:
- (a) The insights gained from the development of the Exposure Draft and the preceding Discussion Paper would be retained.
  - (b) The *Conceptual Framework* would provide some guidance to the Board in the development of accounting Standards.
  - (c) It responds, at least in part, to those respondents that expressed the view that the Measurement chapter requires further development.
  - (d) It would not preclude the possibility of further research being undertaken after the issue of the revised *Conceptual Framework*.

### ***Disadvantages of the build approach***

19. The disadvantages of the build approach include:
- (a) It may not be possible to reach consensus on what changes should be made.
  - (b) Possible changes might require re-exposure, which could delay the issue of a revised *Conceptual Framework*.
  - (c) It might be seen as not adequately responsive to those respondents that suggested further research is necessary.
  - (d) The revised chapter might entrench views that are inconsistent with any further research or insights gained from the development of Standards.

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<sup>2</sup> Christine A. Botosan and Adrienna A. Huffman: ‘Decision-Useful Asset Measurement from a Business Valuation Perspective’, *Accounting Horizons* Vol. 29, No. 4 2015 pp. 757–776.



**Staff recommendation**

20. The staff do *not* recommend Approach A—the discard approach, because in their view it is unsatisfactory for the revised *Conceptual Framework* to provide no guidance on measurement.
21. The staff also do *not* recommend Approach B—the retain approach, because it foregoes the opportunity of making significant improvements to the Measurement chapter.
22. The staff recommend that the Measurement chapter should initially be developed using Approach C—the build approach. This retains the insights gained in developing the Exposure Draft and the preceding Discussion Paper, and allows consideration of possible improvements that might be reflected in the revised *Conceptual Framework*.
23. The staff note that there is a risk that improvements identified in the build approach could require re-exposure. However, the staff do not think that this is a significant risk. The approach is to develop ideas that have already been the subject of consultation, and have met with a good measure of support from constituents. Changes required by the build approach respond to comments from respondents for greater clarity on the links between the various ideas in the Measurement chapter and its implications.
24. The staff note that exploring the build approach would not preclude a change in strategy—perhaps to Approach B, the retain approach—if it becomes clear that the build approach is unachievable. In that event, however, the exploration of the build approach might still have raised issues that could be considered in any future research.

**Question for the Board**

Do you agree with the staff recommendation that the Measurement chapter should initially be developed using Approach C—the build approach?