

STAFF PAPER

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IASB Meeting

Project	Conceptual Framework		
Paper topic	Measurement—redrafting the factors to consider in selecting a measurement basis		
CONTACT(S)	Andrew Lennard	alennard@ifrs.org	+44 (0)20 7246 6930
	Rachel Knubley	rknubley@ifrs.org	+44 (0)20 7246 6904

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Introduction

1. Most respondents that commented on Chapter 6—Measurement in the *Conceptual Framework* Exposure Draft (the Exposure Draft) agreed that:
 - (a) the *Conceptual Framework* should not require the use of a single measurement basis;
 - (b) the measurement bases discussed were appropriate; and
 - (c) the selection of a measurement basis should be based on the objective of financial reporting and the qualitative characteristics of useful financial information.
2. However, some respondents said that the chapter failed to provide adequate guidance for the development of future IFRS Standards. A specific concern was that the link between the sections ‘Measurement bases and the information that they provide’ (paragraphs 6.4–6.47) and ‘Factors to consider when selecting a measurement basis’ (paragraphs 6.48–6.63) in the Exposure Draft was not sufficiently clear.
3. At the July 2016 Board meeting, the Board directed the staff to present at a future Board meeting, a revised discussion about how selecting a measurement basis might be influenced by:

- (a) the characteristics of an asset or a liability; and
 - (b) how an asset or a liability contributes to future cash flows.
4. A revised draft of the relevant sections of the Exposure Draft was discussed by the Board at an Educational Session in September 2016 (Agenda Paper 10H ‘*Measurement: suggested redraft of parts of Chapter 6*’). The same draft was discussed by the Accounting Standards Advisory Forum (ASAF) at its September 2016 meeting. That draft contained expanded guidance on the implications of the ‘factors to consider when selecting a measurement basis’, particularly about the implications for the relevance of particular measurement bases for:
- (a) the contribution of the asset (or liability) to cash flows; and
 - (b) the characteristics of an asset or liability.
5. Discussion at those meetings showed that most agreed that the draft was an improvement on the Exposure Draft and was proceeding along the right lines. However, there was a general view that the draft was too long, and contained too much discussion of examples and detailed points that would be more appropriately addressed in the development of IFRS Standards rather than in the *Conceptual Framework*.
6. The redraft has been developed further reflecting comments made by Board and ASAF members at those meetings. The revised draft is presented in Agenda Paper 10C *Measurement: suggested redraft of parts of Chapter 6*.
7. This paper provides an overview of the main changes that we are proposing to Chapter 6. It mainly focuses on differences between the Exposure Draft and the revised draft. However, comments on the September 2016 redraft are included where they seem helpful.
8. The papers for this session, in addition to this paper, are:
- (a) a revised draft of the relevant sections of Chapter 6—Measurement (Agenda Paper 10C ‘*Measurement: suggested redraft of parts of Chapter 6*’); and
 - (b) a marked-up text that compares the revised draft (Agenda Paper 10C) with the text of the corresponding sections of the Exposure Draft

(Agenda Paper 10D ‘Measurement: comparison of suggested redraft of parts of Chapter 6 with the Exposure Draft’).

9. The purpose of this meeting is:
 - (a) to obtain Board members’ views on points that have arisen during redrafting this material; and
 - (b) to obtain Board members’ general views on the revised draft.
10. The Board is not being asked to approve the revised draft, which is presented simply to illustrate how the issues might be reflected in the measurement chapter.
11. This paper does not cover the following sections of Chapter 6 of the Exposure Draft:
 - (a) Factors specific to initial measurement (paragraphs 6.64–6.73)—this section will be discussed at a future meeting.
 - (b) More than one relevant measurement basis (paragraphs 6.74–6.77)—this section will be discussed at a future meeting.
 - (c) Measurement of equity (paragraphs 6.78–6.80)—this was discussed by the Board in Agenda Paper 10E for the September 2016 meeting.

Structure of this paper

12. An overview of the main changes from the Exposure Draft is given in the next section (paragraph 14). The following sections follow the structure of the revised draft: they are:
 - (a) Introduction (paragraphs 15–20);
 - (b) Measurement bases (paragraphs 21–26);
 - (c) Information provided by different measurement bases (paragraphs 27–31);
 - (d) Factors to consider when selecting a measurement basis: general comments and relevance (paragraph 32);
 - (e) Faithful representation (paragraph 33); and

- (f) Enhancing qualitative characteristics and the cost constraint (paragraphs 34).

13. Questions for the Board are set out after paragraphs 14, 20, 31, 32 and 35.

Overview of changes from the Exposure Draft

14. The principal respects in which the revised draft differs from the Exposure Draft are:

- (a) The section entitled ‘Measurement bases and the information that they provide’ has been divided into two sections: the first, ‘Measurement bases’ provides a brief description of the various measurement bases, and the second ‘Information provided by different measurement bases’ discusses the information provided by each basis.
- (b) Following the Board’s tentative decision at its July 2016 meeting, a discussion of current cost has been retained, but repositioned into the discussion of current values.
- (c) The discussion of the ‘Factors to consider when selecting a measurement basis’ has been expanded, with greater emphasis on the factors that contribute to relevance.
- (d) Discussion of aspects such as complexity and subjectivity has been moved to an expanded final section on the enhancing qualitative characteristics, which has been re-titled ‘Enhancing qualitative characteristics and the cost constraint’.
- (e) In the light of the Board’s tentative decision at its May 2016 meeting, the discussion of measurement uncertainty has been relocated to the discussion of faithful representation with consequential changes.

Question for Board members
Do you agree with the changes described above?

Introduction (Agenda Paper 10C, paragraphs 6.1–6.5)

15. The content of this section of the revised draft is largely brought forward from the Exposure Draft, with minor changes to enhance clarity.
16. The only substantive change is the introduction of paragraph 6.4 which reads:
- 6.4 This Chapter will assist in the selection of a measurement basis for use in particular Standards. Standards may set out how that basis is to be implemented, which may include:
- (a) specifying the techniques to be used to estimate a measure on a particular measurement basis;
 - (b) specifying a proxy measurement basis, for example where the proxy is likely to provide similar information to the selected measurement basis at less cost; or
 - (c) modifying a measurement basis.
17. There seems to be a risk that the Exposure Draft could be interpreted as constraining the Board in the development of future Standards to select from the limited set of measurement bases that are explicitly discussed in the *Conceptual Framework*. The suggested new paragraph 6.4 seeks to provide the Board with an appropriate degree of freedom in the development of new Standards.
18. It is envisaged that the Basis for Conclusions to the *Conceptual Framework* will state that the Board intends to explain the relationship between the measurement requirements of new Standards and the *Conceptual Framework*.
19. Because of the suggested new paragraph, the following material has not been carried forward from the Exposure Draft:
- (a) the suggestion (paragraph 6.35) that value in use and fulfilment value might be customised; and
 - (b) the discussion of the effect of risk premiums and their reversal (paragraphs 6.25 and 6.36).
20. Both of the above points were the subject of some adverse comments from respondents to the Exposure Draft. They may also seem to raise issues that are

more appropriately dealt with in the development of IFRS Standards than in the *Conceptual Framework*.

Questions for Board members

- (a) Do you agree that a paragraph along the lines of the suggested paragraph 6.4 should be included in the *Conceptual Framework*?
- (b) Do you agree that the *Conceptual Framework* should not discuss customisation of value in use and fulfilment value, and risk premiums and their reversals?

Measurement bases (Agenda Paper 10C, paragraphs 6.6–6.26)

21. A few respondents urged clarification of the conceptual basis of historical cost, citing issues such as variable consideration or the purchase of an asset by the exercise of an option.
22. It would not be practicable or commensurate with the rest of the *Conceptual Framework* to provide an exhaustive treatment of the conceptual basis of historical cost. However, the revised draft observes in paragraph 6.7 that:
- Reporting at historical cost a recently acquired asset is justifiable as it is reasonable to assume, in the absence of evidence to the contrary, that the asset will provide economic benefits that at least recover its cost.
23. The following paragraph makes a similar observation for liabilities.
24. The September 2016 redraft included similar wording. We did not specifically ask for comments on them. However, no adverse comments were received.
25. The staff do not consider that the new sentences are controversial. It also thinks that they may be of assistance to the Board when considering certain issues, for example whether the historical cost of an asset should be increased or decreased when the amount of a liability that arose on acquisition of the asset changes.
26. The paragraphs in the revised draft that discuss fair value, value in use and current cost have been brought forward from the Exposure Draft with only minor changes.

Information provided by different measurement bases (Agenda Paper 10C, paragraphs 6.27–6.44)***Historical cost (Agenda Paper 10C, paragraphs 6.27–6.32)***

27. The discussion in the above paragraphs is a combination of material brought forward from the Exposure Draft and new drafting. In summary:
- (a) A new paragraph (6.27) has been inserted to make the points that historical cost reflects the transactions undertaken by the entity and that it indicates that the entity's recognised assets less liabilities are at least as great as the amount at which they are measured at the reporting date.
 - (b) The Exposure Draft noted at paragraphs 6.13 and 6.14 (the substance of which is in paragraph 6.30 of the revised draft) that historical cost gave information on margins, by enabling a comparison of the consideration received from providing goods and services and the cost of the assets consumed in providing them. The discussion of this has been expanded by the inclusion of new paragraphs 6.28 and 6.29: this provides a more secure foundation for the later discussion on the contribution of the asset or liability to cash flows.
 - (c) While the Exposure Draft noted that historical cost measures do not reflect changes in prices (paragraph 6.6) it did not bring out the implications of this point. This is now addressed in paragraph 6.32. Reflecting comments on the September 2016 redraft, this paragraph gives examples of assets where historical cost may not provide relevant information: 'assets...that are held for long periods such as property, plant and equipment and a financial asset or liability that is a derivative'. The Board has previously expressed the view that the measurement chapter should not include many examples. However, some comments suggested that a specific reference to derivative financial instruments is useful, and some have suggested that it is useful to give an example of a non-financial asset, to counter any thought that price changes are relevant only for financial assets.

Fair value (Agenda Paper 10C, paragraphs 6.33–6.37)

28. The main changes to the discussion of information provided by fair value are:
- (a) The Exposure Draft gave (at paragraph 6.29) a specific example of a disaggregation of income and expenses measured at fair value. However, this might have been interpreted as the only possible disaggregation. The revised draft retains the point (in paragraph 6.34) that disaggregation may enhance the decision usefulness of fair value income and expenses: the only example given is ‘separately identifying income or expenses that reflect the time value of money’.
 - (b) A new paragraph (6.35) has been added about the information content of fair value income and expenses: the Exposure Draft only explicitly addressed information about assets and liabilities.
 - (c) A new paragraph (6.36) has been added to make the point that, where assets and liabilities are measured at fair value, income or expenses arising on sale or transfer would be expected to be small, and may not be particularly relevant. This contrasts with the information on margins that is provided where assets and liabilities are measured at cost.

Value in use and fulfilment value (Agenda Paper 10C, paragraphs 6.38–6.41)

29. The paragraphs in the revised draft that discuss the information provided by value in use and fulfilment value have been brought forward from the Exposure Draft with only minor changes.

Current cost (Agenda Paper 10C, paragraphs 6.42–6.43)

30. The revised draft compares the information provided by income and expenses measured at current cost and historical cost, and notes the importance, when current cost is used, of disaggregating holding gains and losses from the cost of consumption.

Table 6.1—Information provided by various measurement bases (Agenda Paper 10C, paragraph 6.44)

31. The table has been revised to enhance clarity, and in particular to highlight differences in the information provided under different measurement bases for different kinds of events. It highlights, for example, that where an asset is measured at historical cost profit or loss is reported on its sale, but that price changes are not generally recognised and, conversely, that fair value reflects price changes, but that profit or loss on sale (apart from the effect of transactions costs) is not likely to be large.

Questions for Board members

- (a) Do you agree with the changes discussed above?
- (b) Do you agree that the *Conceptual Framework* should include the statement in paragraph 6.32 of Agenda Paper 10C that historical cost may not provide relevant information for ‘assets...that are held for long periods such as property, plant and equipment and a financial asset or liability that is a derivative’?

Factors to consider when selecting a measurement basis: general comments and relevance (Agenda Paper 10C, paragraphs 6.45–6.60)

32. This is the section that has been most extensively revised in the new draft. The main changes are:
- (a) Additional emphasis has been placed on the importance of relevance. To achieve this, a new paragraph (6.49) has been inserted which reiterates the main points of paragraph 2.21 of the Exposure Draft within the discussion of the qualitative characteristics of useful financial information.
- (b) An expanded discussion of the significance of the ‘Characteristics of the asset or liability’ is provided at paragraphs 6.53–6.56. This notes (in summary) that:
- (i) if the cash flows are variable, amortised cost may be costly and complex.

- (ii) if the value of an asset is affected by market factors or other risks, a current value may provide more relevant information than historical cost.
 - (iii) if the value of an asset is affected by market factors or other risks, historical cost may not reflect income or expenses in the period in which they arise.
- (c) An expanded discussion of the significance of the ‘Contribution to future cash flows’ is provided at paragraphs 6.57–6.60. This discussion (in summary):
- (i) Builds on the distinction, made in Chapter 1 of the *Conceptual Framework*, between economic resources that generate cash flows directly and those that are used in combination to generate cash flows, and thus generate cash flows indirectly.
 - (ii) Consistently with the Exposure Draft, notes that the distinction depends, in part, on the business activities conducted by the entity.
 - (iii) States that an example of assets that generate cash flows directly are ‘assets that can be sold independently, without a significant economic penalty’.
 - (iv) Suggests that for such assets a current value such as fair value or value in use is likely to be relevant.
 - (v) Suggests that where resources generate cash indirectly a cost-based measurement is likely to be relevant, in particular because it provides information on margins.
 - (vi) Notes that where inventory cannot be sold except by using other resources in production and marketing, and that, where these activities are significant, a cost-based measure is likely to be relevant.
 - (vii) Notes that where assets and liabilities are managed to collect contractual cash flows, a cost-based measurement may be relevant, especially if the contractual cash flows represent principal and interest.

Question for Board members

Do you have any comments on the revised draft's treatment of 'Factors to consider when selecting a measurement basis' as discussed above?

Faithful representation (Agenda Paper 10C, paragraphs 6.61–6.64)

33. The above paragraphs have been brought forward from the Exposure Draft. They include the discussion of measurement uncertainty, which has been relocated from relevance to the discussion of faithful representation with consequential changes.

Enhancing qualitative characteristics and the cost constraint (Agenda Paper 10C, paragraphs 6.65–6.79)

34. This section has been expanded by including a discussion, for each of the measurement bases, of the implications of the enhancing qualitative characteristics and the cost constraint. With one exception, it consists of paragraphs brought forward from the Exposure Draft with only minor changes.
35. The exception is the new paragraph 6.79, which highlights some of the respects in which current cost may be complex and subjective.

Question for Board members

Do you have any further questions or comments on the revised draft set out at Agenda Paper 10C?

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