

## STAFF PAPER

April 2014

## REG IASB Meeting

| Project     | Conceptual Framework          |                   |                  |
|-------------|-------------------------------|-------------------|------------------|
| Paper topic | Initial strategy: Measurement |                   |                  |
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**Purpose of paper**

1. This paper discusses the following possible approaches to the measurement section of the *Conceptual Framework* Exposure Draft:
  - (a) **Approach 1** – do not develop a measurement section of the *Conceptual Framework* Exposure Draft and start a research project on measurement
  - (b) **Approach 2** – build on the proposals in the Discussion Paper, modified in the light of feedback received
  - (c) **Approach 3** – include high-level guidance on measurement in the *Conceptual Framework* Exposure Draft and start research work to develop more detailed measurement concepts.
2. At this meeting we would like you to indicate which of these approaches you would prefer. The staff recommend Approach 2.

**Structure of paper**

3. This paper is structured as follows:
  - (a) Background (paragraphs 4-8)
  - (b) Feedback (paragraphs 9-134)
  - (c) Approaches (paragraphs 15-28)

- (d) Staff recommendation and question for the IASB (paragraphs 29-31).

## Background

4. The existing *Conceptual Framework* provides little guidance on measurement and when particular measurements should be used. It simply:
- (a) defines measurement;
  - (b) describes a number of different measurement bases that are used in financial statements (historical cost, current cost, realisable (settlement) value and present value); and
  - (c) notes that historical cost is most commonly used in preparing financial statements but that it is usually combined with other measurement bases.
5. Consequently, one of the objectives of the *Conceptual Framework* project is to provide more guidance on measurement and the selection of measurement bases.
6. The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the Discussion Paper) suggested guidance that the IASB could include in a revised *Conceptual Framework* to assist the IASB in developing measurement requirements for use in Standards. In particular, the Discussion Paper:
- (a) described how the objective of financial reporting and qualitative characteristics of useful financial information influence measurement requirements.
  - (b) described and discussed the following three categories of measurement:
    - (i) cost-based measurements;
    - (ii) current market prices, including fair value; and
    - (iii) other cash-flow based measurements.
  - (c) discussed how to identify an appropriate measurement.
7. The Discussion Paper included the following preliminary views on measurement:

- (a) The objective of measurement is to contribute to the faithful representation of relevant information about:
    - (i) the resources of the entity, claims against the entity and changes in resources and claims; and
    - (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.
  - (b) A single measurement basis for all assets and liabilities may not provide the most relevant information for users of financial statements.
  - (c) When selecting which measurement to use for a particular item, the IASB should consider what information that measurement will produce in both the statement of financial position and the statement(s) of profit or loss and OCI.
  - (d) The relevance of a particular measurement 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:
    - (i) for a particular asset should depend on how that asset contributes to future cash flows; and
    - (ii) for a particular liability should depend on how the entity will settle or fulfil that liability.
  - (e) the number of different measurements used should be the smallest number necessary to provide relevant information. Unnecessary measurement changes should be avoided and necessary measurement changes should be explained.
  - (f) the benefits of a particular measurement to users of financial statements need to be sufficient to justify the cost.
8. The Discussion Paper also described the implications of these preliminary views for the measurement of different types of assets and liabilities.

**Feedback**

9. Many respondents supported the overall direction of the approach to measurement proposed in the Discussion Paper. In particular, they:

- (a) Supported not selecting a single measurement basis that would be used for all assets and liabilities (ie a mixed measurement approach).
- (b) Agreed that the selection of a measurement basis:
  - (i) for a particular asset should depend on how that asset contributes to future cash flows; and
  - (ii) for a particular liability should depend on how the entity will settle or fulfil that liability.

Many respondents interpreted this approach as meaning that the IASB would consider an entity's business model when selecting an appropriate measurement basis (and supported using the business model in this way).

- (c) Agreed that the IASB should consider the information produced in both the statement of financial position and the statement(s) of profit or loss and OCI when the IASB selects a measurement basis.

10. However, some respondents disagreed with the approach to measurement suggested in the Discussion Paper (and in particular the mixed measurement approach). Suggestions for different approaches to measurement included:

- (a) fair value as the default measurement basis;
- (b) cost as the default measurement basis;
- (c) deprival/relief value;
- (d) current market-based measurement; and
- (e) defining a concept of wealth to derive an ideal measurement basis.

11. Although many respondents agreed with the overall approach to measurement suggested in the Discussion Paper, some respondents expressed the view that the measurement section:

- (a) requires more thought and analysis;

- (b) simply codifies existing practice; and
  - (c) includes too much standards-level detail.
12. A number of suggestions were made to address the concerns:
- (a) We should delay issuing an Exposure Draft of the *Conceptual Framework* until we have undertaken more research on measurement.
  - (b) We should exclude measurement from the Exposure Draft of the *Conceptual Framework* and start a separate research project on measurement.
  - (c) We should consider a two-step approach to the measurement section. The first step would develop limited interim guidance on measurement that could be used until rigorous concepts and principles can be developed.
13. A few respondents also stated that link between the measurement section and the section on OCI should be explored. It was stated that decisions about measurement drive the use of OCI, particularly if the IASB decides to use OCI because it concludes that more than one measurement basis is relevant.
14. The approach to the measurement section of the *Conceptual Framework* was discussed at the Accounting Standards Advisory Forum (ASAF) meeting in March. Although some ASAF members supported the overall approach to measurement suggested in the Discussion Paper, many expressed the view that this section needed more work and suggested one of the approaches to the measurement section outlined in paragraph 12.

## Approaches

15. The staff do not believe it is necessary or appropriate to delay issuing an Exposure Draft of the *Conceptual Framework* until we have undertaken more research on measurement. If you believe further research is needed on measurement, this can be started without delaying the publication of a revised (and improved) *Conceptual Framework*.

16. The staff have identified three main approaches to the measurement section that you could consider:
- (a) **Approach 1** – do not develop a measurement section of the *Conceptual Framework* Exposure Draft and start a research project on measurement (paragraphs 17-20)
  - (b) **Approach 2** – Build on the proposals in the Discussion Paper, modified in the light of feedback received (paragraphs 21-25).
  - (c) **Approach 3** – Include high-level guidance on measurement in the *Conceptual Framework* Exposure Draft and start research work to develop more detailed measurement concepts (paragraphs 26-28).

***Approach 1 – Do not develop a measurement section***

17. Under this approach we would not develop measurement guidance for the *Conceptual Framework* Exposure Draft. Instead, we would carry out detailed research on measurement which could generate material to be added to the *Conceptual Framework* at a later date.
18. If this approach is adopted, we would need to decide whether to retain or remove the limited guidance on measurement that is included in the existing *Conceptual Framework*.
19. The main advantages of Approach 1 are:
- (a) It responds to calls for more work on measurement. We could undertake detailed research into other approaches to measurement such as those described in paragraph 10.
  - (b) It does not tie us to concepts that we may subsequently want to change.
  - (c) It could provide us with more time to fully develop measurement concepts.
20. The main disadvantages of Approach 1 are:
- (a) It does not respond to those who believe that the *Conceptual Framework* needs to provide measurement guidance.

- (b) Research could take a long time and there is no guarantee that we will succeed.
- (c) Until the research work has been completed and the *Conceptual Framework* has been updated, we would have no guidance on developing measurement requirements (other than the existing very limited guidance).

***Approach 2 – Develop the proposals in the Discussion Paper***

- 21. Under Approach 2, we would analyse the comments received on the preliminary views expressed in the Discussion Paper and develop proposals for measurement guidance building on the approach suggested in the Discussion Paper.
- 22. We would not propose to undertake significant additional research work on measurement. In particular, we would not propose to develop in detail the other approaches suggested by respondents (see paragraph 10). However, we will provide you with a paper that:
  - (a) describes the approaches suggested by respondents;
  - (b) discusses their advantages and disadvantages;
  - (c) asks whether you would like to develop any of these approaches further.
- 23. In response to some of the comments that we received on the Discussion Paper, we propose to make a number of changes to the way that measurement is addressed:
  - (a) We agree with those respondents to the Discussion Paper who stated that it included too much standards-level detail. Consequently, we would remove much of the discussion of the implications of the proposed approach to measurement for particular types of assets and liabilities.
  - (b) We believe that the measurement section should focus on:
    - (i) describing the different measurement bases;
    - (ii) describing the information that the different measurement bases might provide in both the statement of financial position and the statement(s) of profit or loss and OCI;

(iii) discussing the factors that might make a particular measurement basis more useful to the users of financial statements.

(c) We would explain the link between the measurement section and the discussion of other comprehensive income.

24. The main advantages of Approach 2 are:

(a) It provides you with much-needed guidance that you can use in setting measurement requirements;

(b) It is responsive to calls for guidance on measurement;

(c) It builds on proposals that were broadly supported by respondents to the Discussion Paper.

25. The main disadvantages of Approach 2 are:

(a) It does not respond to those who believe we should undertake significant additional research work on measurement.

(b) It could tie us into concepts that we may subsequently want to change.

***Approach 3 – Include high-level guidance and start further research***

26. Under Approach 3, we would develop high-level guidance on measurement (for example, simply describing the different measurement bases and the information that they provide) and start research work to develop more detailed concepts of measurement (for example, considering in detail the approaches mentioned in paragraph 10).

27. The main advantages of this approach are:

(a) It provides high-level guidance to help you develop measurement guidance.

(b) It responds to calls for more work on measurement.

(c) It does not tie us to concepts that we might subsequently want to change.



28. The main disadvantages of Approach 3 are:
- (a) Any high-level guidance developed could be in place for a long time (the research work could take a long time and might not succeed at all).
  - (b) High-level guidance may not be enough to help you develop measurement requirements.
  - (c) We may need to change the *Conceptual Framework* once the research work has been completed.

### **Staff recommendation and question for the IASB**

29. The staff note that much research has been done on measurement over the years. However there is no clear consensus on the best approach to measurement. Consequently, the staff is concerned that any research project on measurement would take a long time to complete and may not succeed. The staff also believe that there is an urgent need for guidance that could help the IASB develop consistent approaches to measurement. Consequently, the staff do not support Approach 1.
30. Approach 3 would provide you with high-level guidance for developing measurement requirements and respond to calls for more research. However, the staff believe that it should be possible to develop guidance that goes further than the limited guidance suggested under this approach. More detailed guidance (along the lines suggested in Approach 2) would be more likely to be useful in setting measurement requirements. Consequently, the staff support Approach 2 – build on the proposals in the Discussion Paper along the lines suggested in paragraph 23.
31. Although the staff are not recommending that you commit now to undertaking a broad-scope research project on measurement, we believe that possible future research projects (eg research work on high-inflation, foreign exchange, discount rates) could provide insights into aspects of measurement. If this is the case, the staff believe that you should consider whether to revise the *Conceptual Framework* to reflect concepts identified during that work (ie we should not consider the *Conceptual Framework* to be set in stone).

**Question for the IASB**

The staff recommend that we should build on the proposals in the measurement section of the Discussion Paper along the lines suggested in paragraph 23 (**Approach 2**).

Do you agree?