

## STAFF PAPER

October 2014

## REG IASB Meeting

Project	Conceptual Framework		
Paper topic	Measurement – Measurement bases		
CONTACT(S)	Rachel Knubley	rknubley@ifrs.org	+44 207 246 6904

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

**Purpose of paper**

1. At the September 2014 meeting, the IASB discussed a second working draft of the description and discussion of measurement bases for the Exposure Draft (September 2014: AP10B – *Measurement bases*). At that meeting, you instructed the staff to bring a paper to a future meeting that:
  - (a) categorises measurement bases as either historical or current. You asked the staff to consider whether the distinction between historical and current measurement bases could be based on whether the measurement depends on the original transaction price; and
  - (b) describes amortised cost as a historical cost measurement.
2. Consequently, the appendix to this paper provides a revised working draft of the description and discussion of measurement bases for the Exposure Draft. Paragraphs 7–10 of this paper describe the main changes we have made to the draft presented at the September 2014 meeting.
3. Paragraphs 5–6 of this paper explain the interaction between the tentative decisions made so far on the selection of a measurement basis and the description and discussion of measurement bases proposed in the appendix.
4. The measurement section of the *Conceptual Framework* was discussed at the September Accounting Standards Advisory Forum (ASAF) meeting. AP10A – *Cover paper* includes a draft summary of comments made by ASAF members.

**Interaction between the tentative decisions on selection of a measurement basis and the description and discussion of measurement bases**

5. The IASB has already made a number of tentative decisions about the selection of a measurement basis, including the following:
- (a) consideration of the objective of financial reporting, of the qualitative characteristics of useful information and of the cost-benefit constraint is likely to result in the IASB selecting different measurement bases for different assets and liabilities;
  - (b) the Exposure Draft should describe how the qualitative characteristics of relevance and faithful representation and the enhancing qualitative characteristics affect the selection of a measurement basis;
  - (c) when the IASB selects a measurement basis, it should consider the nature and relevance of the resulting information produced in both the statement of financial position and the statement(s) of profit or loss and other comprehensive income (OCI);
  - (d) it may be appropriate to use one measurement basis for the statement of financial position and a different measurement basis for the statement of profit or loss when such an approach better reflects the nature of the business activities conducted;
  - (e) the factors to be considered when selecting a measurement basis for an asset or liability should include:
    - (i) how the asset or liability will contribute to future cash flows. This will depend in part on the nature of the business activities being conducted; and
    - (ii) the characteristics of the asset or liability (for example, the nature or extent of the variability in the item's cash flows, the sensitivity of the value of the item to changes in market factors or other risks inherent in the item);
  - (f) the Exposure Draft should discuss how the level of uncertainty associated with a measurement basis might affect the relevance of that measurement basis;

- (g) the Exposure Draft should state explicitly in the measurement section that the cost constraint is one of the factors the IASB should consider when selecting a measurement basis and that the benefits of introducing a new or different measurement basis should be weighed against any increased costs or complexity;
  - (h) the relative importance of each of the factors to be considered when selecting a measurement basis will depend upon facts and circumstances.
6. The tentative decisions listed in paragraph 5 are intended to provide you with guidance on the factors to consider when selecting a measurement basis. The purpose of the description and discussion of the measurement bases in the appendix is to provide you with information about the different measurement bases to help you make that selection. In particular, the appendix describes:
- (a) the information that different measurement bases provide in the statement of financial position and the statement statement(s) of profit or loss and OCI;
  - (b) the features of the measurement bases which may make them suitable in some situations but not in others.

### **Changes made to the September 2014 working draft**

7. The staff have made the following changes to the working draft of the description and discussion of measurement bases:
- (a) Categorized measurement bases as historical cost or current. We explain that:
    - (i) measurements based on historical cost provide monetary information about resources, claims and changes in resources and claims using information about past transactions (for example, transaction prices);
    - (ii) current measurement bases are updated to reflect conditions at the measurement date.

- (b) Described amortised cost as a historical cost measurement basis for financial assets and financial liabilities.
- (c) Described fair value, fulfilment value and value in use as examples of current measurement bases. We have noted that fair value considers the perspective of market participants but fulfilment value and value in use use entity-specific estimates of cash flows.
- (d) Removed most of the discussion of the differences between entry and exit values. This was done in response to comments made by some IASB members that the distinction between entry and exit values would be unlikely to be useful in selecting a measurement basis and may not be understood by some stakeholders.
- (e) Removed most of the discussion of current cost. At the September 2014 IASB meeting, it was suggested that, because current cost is not currently used in our Standards and we have no current plans to use it in the future, a detailed description of this measurement basis is unnecessary. However, we have retained a single paragraph (A7) that discusses when current cost might provide more relevant information than historical cost.
- (f) Removed the description of net realisable value. The staff believe it is unnecessary to separately describe net realisable value because it is simply a current measurement basis for assets that has been adjusted to reflect transaction costs (costs of sale).
- (g) Moved the tables that describe the information that different measurement bases provide in the statement of financial position and the statement of comprehensive income. They are now in an appendix, not in the main body of the text.

8. In addition, we have made some significant changes to the discussion of cash-flow-based measurement techniques (see paragraphs A32–A35):

- (a) We have incorporated the discussion of cash-flow-based measurement techniques into the section that discusses current measurement bases. We note there that cash-flow-based measurement techniques are often used to estimate current measurement bases; and

- (b) We have removed most of the discussion of the factors to consider when using a cash-flow-based measurement.
9. We believe that the changes to the discussion of cash-flow-based measurement techniques described in paragraph 8 are consistent with the tentative decision you made in July 2014 that cash-flow-based measurements are not measurement bases in their own right. They are instead a measurement technique used to estimate a current measurement. Although the staff believe that the detailed discussion of the factors to consider when using a cash-flow-based measurement is potentially useful, we believe that the level of detail originally proposed is excessive for the description of a measurement technique in the *Conceptual Framework*.
10. The staff propose to retain a discussion of the advantages and disadvantages of using cash-flow-based measurement techniques to customise measurement bases (paragraph A35) as we believe that this is potentially useful to the IASB.

### Questions for the IASB

**Question 1 – Changes to the working draft**

Do you support the changes made to the working draft described in paragraph 7?

**Question 2 – Changes to the discussion of cash-flow-based measurement techniques**

Do you support the changes made to the discussion of cash-flow-based measurement techniques described in paragraphs 8–10?

**Question 3 – Other comments**

Do you have any other comments on the description and discussion of measurement bases in Appendix A?

## Appendix A – Description of different measurement bases

This appendix includes a revised working draft for the description and discussion of measurement bases in *Conceptual Framework Exposure Draft*. It is intended to give IASB members an idea of the broad content and level of detail envisaged by the staff. We plan to work further on the drafting. Consequently, we are not seeking detailed drafting comments at this stage.

### Measurement bases

- A1. Paragraphs XX – XX discuss the factors to be considered when selecting a measurement basis. The following paragraphs describe different measurement bases and the information that they provide.
- A2. Measurement bases can be categorised as:
- (a) historical cost (paragraphs A3–A11); or
  - (b) current measurement bases (paragraphs A12–A35).

### *Historical cost*

- A3. Measurements based on historical cost provide monetary information about resources, claims and changes in resources and claims using information about past transactions (for example, transaction prices). The initial measurement of assets or liabilities measured at historical cost is not adjusted to reflect changes in prices. However, the carrying amount is adjusted over time to reflect changes such as consumption, impairment and fulfilment.
- A4. For example, on the historical cost basis for non-financial assets and non-financial liabilities:
- (a) assets are initially measured at the time of the asset's acquisition or construction at an amount equal to the value of the consideration given to acquire the asset. The carrying amount is adjusted over time to reflect:

- (i) consumption—depreciation and amortisation are designed to reflect the consumption of the economic resource that constitutes the asset; and
  - (ii) impairment—impairment is designed to reflect the fact that part of the historical cost of the asset is no longer recoverable; and
- (b) liabilities are initially measured at the time the liability is incurred at an amount equal to the value of the consideration received. The carrying amount is adjusted over time to reflect:
- (i) fulfilment of the liability; and
  - (ii) increases in estimated cash outflows (onerous liabilities)—increasing a liability when it becomes onerous is designed to reflect the fact that the historical proceeds are no longer sufficient to fulfil the liability.

A5. The information provided by historical cost measurement of non-financial assets and non-financial liabilities is summarised in the following table:

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Historical cost: Non-financial assets</b>	<ul style="list-style-type: none"> <li>• Recoverable cost of (the unconsumed part of) an asset</li> </ul>	<ul style="list-style-type: none"> <li>• Historical cost of the economic resources consumed in the period (through cost of sales, depreciation, amortisation etc)</li> <li>• Gains or losses on sales of assets during the period</li> <li>• Impairment losses (compared with previous historical cost)</li> </ul>

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Historical cost:</b>  <b>Non-financial liabilities</b>	<ul style="list-style-type: none"> <li>• Historical proceeds for undertaking the unfulfilled part of a liability, plus any excess of the present value of the estimated cash flows over the historical proceeds</li> </ul>	<ul style="list-style-type: none"> <li>• Consideration provided by customers (or others) for obligations fulfilled by the entity during the period</li> <li>• Gains or losses on settlement/transfers of liabilities in the period</li> <li>• Losses on liabilities that have become (more) onerous during the period</li> </ul>

- A6. Historical cost has predictive value. Information about the proceeds from supplying goods and services in the past, and about the past consumption of assets (including services) can be used as one input 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). For example, information about past margins can be used as one input in predicting future margins. In many cases, users focus in their estimates of cash flows on information about the cost of, and proceeds for, goods and services sold over time and they use this information as inputs in assessing cash flows. Users are often less interested in the current value of the goods held at the end of the reporting period.
- A7. However, information about the historical cost of assets and liabilities may sometimes be less useful than information about their current cost (ie the cost of the asset or the proceeds from an equivalent liability at the measurement date) particularly when price changes are significant. Even when annual price changes are not significant, their cumulative effect may sometimes reduce the usefulness of historical information. In addition, reporting income and expenses based on current costs:
- (a) may sometimes be more useful for predicting future margins than information based on historical costs; and



- (b) would be necessary if a physical capital maintenance concept was used in financial statements.
- A8. In many situations, information about historical cost is simpler and less expensive to provide than information using current measurement bases. In addition, the historical cost basis of measurement is generally well understood and in many cases is verifiable.
- A9. However, cost or proceeds can be difficult to determine when there is no observable transaction price for the asset or liability being measured. In addition, estimating depreciation and identifying impairment losses or onerous liabilities can be highly subjective.
- A10. In addition, under the historical cost measurement basis, similar assets that are acquired at different times can be reported in the financial statements at very different amounts. This potentially reduces comparability between reporting entities.
- A11. The term ‘amortised cost’ is sometimes used to refer to a historical cost measurement basis for financial assets and financial liabilities. The initial carrying amount of assets and liabilities measured using amortised cost does not reflect subsequent changes in prices but does reflect subsequent changes such as impairment, accrual of interest and cash payments or receipts.

### ***Current measurement bases***

- A12. Current measurement bases are updated to reflect conditions at the measurement date. The following paragraphs describe the following current measurement bases:
- (a) fair value (see paragraphs A14–A21);
- (b) fulfilment value for liabilities and value in use for assets (see paragraphs A22–A31).
- A13. In some situations, the current value of an asset or liability can be observed directly. However, in other situations current values must be estimated. One way to estimate a current value is using a cash-flow-based measurement technique.

Cash-flow-based measurement techniques are discussed in paragraphs A32–A35.

*Fair value*

- A14. 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.
- A15. Fair value is determined from the perspective of market participants. That is, the asset or liability is measured using the same assumptions that market participants would use when pricing the asset or liability if those market participants act in their economic best interest.
- A16. The information provided by fair value is summarised in the following table:

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Fair value: Assets</b>	<ul style="list-style-type: none"> <li>• Price that would be received to transfer the asset</li> </ul>	<ul style="list-style-type: none"> <li>• Fair value, at the time of consumption, of economic resources consumed during the period</li> <li>• Fair value gains and losses on assets held during the period. Those gains and losses could arise from: changes in estimates of cash flows, changes in interest rates or changes in both the amount and price of risk required by market participants<sup>1</sup></li> <li>• Transaction costs incurred for assets acquired or transferred during the period</li> </ul>

---

<sup>1</sup> These fair value gains and losses may sometimes be disaggregated into components, for example, interest income and interest expense, release of risk premiums etc.

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Fair value: Liabilities</b>	<ul style="list-style-type: none"> <li>• Price that would be paid to transfer the liability</li> </ul>	<ul style="list-style-type: none"> <li>• Fair value, at the time of performance, of performance obligations fulfilled during the period</li> <li>• Fair value gains and losses on liabilities held during the period. Those gains and losses could arise from: changes in estimates of cash flows, changes in interest rates or changes in both the amount and price of risk required by market participants<sup>2</sup></li> <li>• Transaction costs incurred for liabilities incurred or transferred during the period</li> <li>• Changes in the premium required by market participants for the risk of non-performance by the reporting entity</li> </ul>

A17. Fair value has predictive value because it reflects market participants’ expectations about the amount, timing and uncertainty of the cash flows as well as their risk preferences. (However, it does not reflect entity specific cash flows if those cash flows differ from the cash flows expected by market participants.) In addition, confirmatory value is provided by comparisons of previous fair values to actual market outcomes.

A18. The fair value of an asset reflects an expectation of profit sufficient to induce market participants to buy the asset at that price. That profit is recognised as the

---

<sup>2</sup> These fair value gains and losses may sometimes be disaggregated into components, for example, interest income and interest expense, release of risk premiums etc.

entity is released from the risk or other factors that generate the profit. Similarly, the fair value of a liability provides an expectation of profit sufficient to induce market participants to assume the liability.

- A19. Measuring at fair value assets that are held solely for use or collection, or liabilities held solely for fulfilment, will result in the recognition in comprehensive income of gains and losses arising from market movements. Depending on the item that is being measured and the nature of the entity's business activities, users may not find the recognition of such gains or losses relevant or understandable.
- A20. Because fair value is determined from the perspective of market participants, rather than the perspective of the entity, and is independent of when the asset or liability was acquired or incurred, identical assets will be measured at the same amount. This arguably produces comparability between entities.
- A21. If the fair value of an asset or liability can be observed in an active market, then fair value measurement is simple, normally easy to understand and verifiable. If, however, the fair value of an asset or liability cannot be observed, valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate the fair value of the item being measured. Depending on the techniques used, this estimation process can be costly and complex. In addition, in some cases, the verifiability of the techniques used to estimate fair value may be questionable. In extreme cases, the measurement uncertainty associated with estimates of fair value may be so great that measurement at fair value may not provide relevant information. However, in other cases a highly uncertain fair value measurement may be the only relevant measurement for an item.

#### *Fulfilment value and value in use*

- A22. The fulfilment value of a liability is the present value of the cash flows estimated to arise from fulfilling the liability. The equivalent measurement basis for assets is value in use. The value in use of an asset is the present value of the cash flows estimated to arise from the continuing use of the asset and from its disposal at the end of its useful life.

A23. Fulfilment value and value in use are entity specific values. They cannot be directly observed and are determined using discounted cash flow techniques that:

- (a) reflect the price for bearing the uncertainty inherent in the cash flows (ie a risk premium) and, if applicable, a profit margin;
- (b) for liabilities, do not normally reflect the risk of non-performance by the reporting entity.

A24. The information provided by fulfilment value and value in use is summarised in the following table:

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Fulfilment value: Liabilities</b>	<ul style="list-style-type: none"> <li>• Present value of cash flows estimated to arise in fulfilling the liability</li> </ul>	<ul style="list-style-type: none"> <li>• Consideration for performance obligations fulfilled during the period</li> <li>• Gains and losses arising from changes in fulfilment value. Those gains and losses could arise from changes in: estimates of cash flows, changes in interest rates, changes in risk premiums required by the entity<sup>3</sup></li> <li>• Unwind of discount</li> </ul>

---

<sup>3</sup> These gains and losses may sometimes be disaggregated into components.

	<b>In the statement of financial position</b>	<b>In the statement of comprehensive income</b>
<b>Value in use:</b> <b>Assets</b>	<ul style="list-style-type: none"> <li>• 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</li> </ul>	<ul style="list-style-type: none"> <li>• Value in use, at the time of performance, of economic resources consumed during the period</li> <li>• Gains and losses arising from remeasurement. Those gains and losses could arise from: changes in estimates of cash flows, changes in interest rates or changes in both the amount and price of risk<sup>4</sup></li> <li>• Unwind of discount</li> </ul>

A25. Fulfilment value provides information about the estimated cash flows to fulfil an obligation and, consequently, has predictive value. In addition, confirmatory value is provided by comparisons of previous fulfilment values to actual outcomes.

A26. Entities normally fulfil liabilities, rather than transfer them or settle them through negotiation with the counterparty. However, if a liability will be transferred, or if settlement will be negotiated with the counterparty, fulfilment value is likely to be less relevant than fair value.

A27. Value in use provides information about the estimated cash flows from the continued use of an asset and from its disposal at the end of its useful life. Consequently, it has predictive value and can be used to assess the prospects for future cash flows to an entity. In addition, confirmatory value is provided by comparisons of previous values to actual outcomes.

A28. Value in use and fulfilment value are determined using discounted cash flow techniques. As noted in paragraph A21, these techniques can sometimes be

<sup>4</sup> These gains and losses may sometimes be disaggregated into components.

costly and complex to apply, and the resulting numbers may be difficult to verify.

- A29. For many assets that are used in combination with other assets, value in use cannot be determined meaningfully for individual assets. Instead the value in use of a group of assets must be determined and the result allocated to individual assets. Consequently, value in use may not be a practical measurement basis for periodic remeasurements of assets used in combination with other assets. However, it may be useful for one-off remeasurements of assets (for example, when the carrying amount of an asset measured using a cost based measurement is no longer fully recoverable—that is, the asset is impaired).
- A30. 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.
- A31. Value in use and fulfilment value are entity specific values. Consequently, similar assets and liabilities in different entities could be measured differently, thereby reducing comparability. However, for unique items, measurement from a market perspective and measurement from the entity’s perspective are likely to be similar. This is because in most cases there is little reason to assume that market participants would use estimates different from those used by the entity.

*Cash-flow-based measurement techniques*

- A32. Cash-flow-based measurement techniques are often used to estimate current measurement bases. For example:
- (a) the value in use of an asset and the fulfilment value of a liability can only be determined using cash-flow-based measurement techniques;
  - (b) when fair value or current cost cannot be observed directly, it may be necessary to estimate these amounts using a cash-flow-based measurement technique or other technique.
- A33. When using a cash-flow-based measurement technique, it is necessary to identify the objective of using the technique and, in the light of that objective, whether the technique should include the following factors:

- (a) the estimated amount, timing and uncertainty of future cash flows for the asset or liability being measured. Those estimates should reflect possible variations in the amount and timing of the cash flows;
- (b) the time value of money;
- (c) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium). The price for bearing the uncertainty inherent in the cash flows depends on the uncertainty but is not the same thing. It reflects the fact that investors would pay less for an asset (expect to receive more for assuming a liability) that has uncertain cash flows than for an asset (liability) whose cash flows are certain;
- (d) other factors, such as liquidity, that market participants would take into account in the circumstances; and
- (e) for a liability, the risk that the reporting entity may fail to fulfil the liability (credit risk).

A34. Not all of the factors listed in paragraph A33 are considered in every cash-flow-based measurement. However, if a cash-flow-based measurement technique is used to estimate fair value, it will need to capture all of the elements and to adopt the perspective of market participants. Estimates of fulfilment value or value in use adopt the perspective of the entity. Fulfilment value does not normally reflect the risk of non-performance by the reporting entity.

A35. Cash-flow-measurement techniques can be used to customise measurement bases (for example by choosing to update only some of the factors listed in paragraph A33). Customising measurement bases may result in more relevant information to the users of financial statements. However, when deciding whether to customise a measurement basis, the IASB would need to consider whether it will be understandable for users of financial statements. If the IASB decides to use a cash-flow-based measurement in this way, the Basis for Conclusions on that Standard should explain why.