

STAFF PAPER

September 2016

IASB Meeting

Project	Conceptual Framework		
Paper topic	Measurement—redrafting the factors to consider in selecting a measurement basis		
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Introduction

1. In July 2016, 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.
2. In response to the Board's request, the staff have redrafted key sections of Chapter 6—'Measurement' of the Exposure Draft *Conceptual Framework for Financial Reporting* (the Exposure Draft). (See Agenda Paper 10H.)
3. The purpose of this Education Session is to obtain initial reactions from Board members on the concepts described in the proposed redraft. We are not, at this stage, seeking drafting comments. We are not, in fact, seeking any decisions from the Board at this meeting.
4. We will also present and seek comments on the proposed redraft of Chapter 6—'Measurement' from the Accounting Standards Advisory Forum (ASAF) at its September meeting. We shall give ASAF an oral summary of the Board's initial reactions to the proposed redraft.

5. The proposed redraft will be reconsidered in the light of comments from Board and ASAF members. The Board will be asked to make tentative decisions on a revised draft at its October meeting.
6. The papers for this session, in addition to this cover paper, are:
 - (a) a revised draft of the relevant sections of Chapter 6—‘Measurement’ (paper 10H); and
 - (a) a set of slides that will assist in focusing the discussion (paper 10I).

Structure of this paper

7. This paper is structured as follows:
 - (a) The next section provides further background information (paragraphs 8–11)
 - (a) a summary of the section of the Exposure Draft headed ‘Factors to consider when selecting a measurement basis’ (paragraph 12)
 - (b) a summary of the approach taken in redrafting ‘Factors to consider when selecting a measurement basis’ (paragraphs 13–19); and
 - (c) questions for discussion by Board members (following paragraph 19).

Background

8. Most respondents that commented on Chapter 6—‘Measurement’ in the Exposure Draft agreed that:
 - (a) the *Conceptual Framework* should not require the use of a single measurement basis;
 - (a) the measurement bases discussed were appropriate; and
 - (b) the selection of a measurement basis should be based on the objective of financial reporting and the qualitative characteristics of useful financial information.

9. However, some respondents said that the Chapter failed to provide adequate guidance for the development of future accounting standards. A specific concern mentioned 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) was not sufficiently clear.
10. A revised draft of the relevant sections forms paper 10H *Measurement: suggested redraft of parts of Chapter 6* for this meeting. To provide context, this draft includes the preceding material. We suggest, however, that the discussion focus on ‘Factors to consider when selecting a measurement basis’ (from paragraph 6.48).
11. A summary of the main changes made to the preceding sections is set out in the Appendix to this paper. Although we do not plan to discuss these changes at the Educational Session, we would appreciate comments on them from Board members offline.

Summary of the Exposure Draft’s discussion of ‘Factors to consider when selecting a measurement basis’

12. The section of the Exposure Draft headed ‘Factors to consider when selecting a measurement basis’:
 - (a) emphasised the importance of qualitative characteristics in the selection of a measurement basis (paragraphs 6.48–6.52).
 - (a) discussed factors relating to relevance, stating that, in selecting a measurement basis, it is important to consider what information that basis will produce in both the statement of financial position and the statement(s) of financial performance.
 - (b) identified two factors to consider when selecting a measurement basis without explicitly stating how the consideration of these factors might affect the conclusion reached. These were described as follows:
 - (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).

- (c) discussed measurement uncertainty as a factor affecting the relevance of information provided by a measurement basis, and distinguished measurement uncertainty and outcome uncertainty.
- (d) discussed the implications for the selection of a measurement basis of faithful representation and the enhancing qualitative characteristics of comparability, verifiability and understandability.

Approach to redrafting

13. Comments from respondents to the Exposure Draft suggest that the most significant change required is to clarify both the underlying principles and the implications of the following factors:
 - (a) the contribution of the asset to future cash flows (see paragraphs 6.54A–6.54G of Agenda Paper 10H); and
 - (a) the characteristics of the asset (see paragraphs 6.54H–6.54K of Agenda Paper 10H).
14. The proposed redraft draws on discussions in earlier parts of the *Conceptual Framework* and reflects insights gained from the development of IFRS 9 *Financial Instruments*.
15. One way of making the guidance in the Chapter 6—‘Measurement’ more robust would be to prescribe the order in which the various factors would be considered and hence their priority (for example, using a hierarchy or decision tree).

However, because the factors' relative importance depends on specific circumstances, a detailed prescription does not seem to be achievable. Reflecting this view, the proposed redraft does not prescribe the order in which the various factors would be considered. Indeed, more emphasis has been given to the thought that no one factor considered in isolation will be conclusive as to the measurement basis that should be selected (paragraph 6.49B of Agenda Paper 10H).¹

16. In the proposed redraft, we have moved the point that it is important, when selecting a measurement basis, for the entity to consider what information the measurement basis will produce in the statement of financial position and the statement(s) of financial performance. This is now in the introduction of the 'factors to consider...' discussion (at paragraph 6.49c) because it applies generally to measurement. In the ED, the guidance was provided in paragraph 6.53, under the subheading 'Relevance.'
17. However, the proposed redraft emphasises (in paragraph 6.49A) the importance of relevance, referring to paragraph 2.21 of the Exposure Draft. That paragraph reads:

The most efficient and effective process for applying the fundamental qualitative characteristics would usually be as follows (subject to the effects of enhancing characteristics and the cost constraint, which are not considered in this example). First, identify an economic phenomenon that is capable of being useful to users of the reporting entity's financial information. Second, identify the type of information about that phenomenon that would be most relevant if it is available and can be faithfully represented. Third, determine whether that information is available and can be faithfully represented. If so, the process of satisfying the fundamental qualitative characteristics ends at that point. If not, the process is repeated with the next most relevant type of information.

¹ The Exposure Draft noted that 'The relative importance of each of the factors [discussed in this section] will depend upon facts and circumstances'.

18. It is important that the *Conceptual Framework* should discuss faithful representation and the enhancing qualitative characteristics of comparability, verifiability and understandability. However, because these enhancing characteristics are considered only after a relevant measurement basis has been identified, it would be unhelpful to expand that discussion to address their potential implications. This would either simply state the obvious or incur the risk of suggesting that specific requirements would be adopted in Standards, without an adequate consideration of relevance. For this reason, the proposed redraft does not attempt to identify specific implications of faithful representation and the enhancing qualitative characteristics.
19. At its May meeting, the Board tentatively decided to describe measurement uncertainty as a factor affecting faithful representation, rather than affecting relevance. Accordingly, the discussion of measurement uncertainty has been relocated to the discussion of faithful representation with minor consequential changes.

Questions for Board members to discuss

What are your views on:

- (a) The general approach adopted in the redrafting, as reflected in the draft at Paper 10H, at paragraphs 6.54–6.54K?
- (b) The discussion of the contribution of the asset to future cash flows (Paper 10H, paragraphs 6.54A–6.54G)?
- (c) The discussion of the characteristics of the asset or liability (Paper 10H, paragraphs 6.54H–6.54K)?
- (d) Are there any other specific points on which you would wish to comment?

Appendix A

Summary of other changes made in the draft.

The following provides a summary of the main changes made in redrafting the Exposure Draft that are reflected in Paper 10H, other than those in paragraphs 6.54–6.54K.

Section	Paragraphs	Description of change
Introduction	6.1–6.3B	Redrafted for clarity.
Historical cost	6.6–6.17A	Discussion expanded to enhance the flow, and to expand the discussion of the information provided by historical cost.
Current cost	6.20A–6.20C	In line with the tentative decision made in July 2016, this has been relocated from the discussion of historical cost, and discussion of advantages and disadvantages expanded.
Summary of information provided	6.47, Table 6.1	Table rewritten to enhance clarity and add a description of the information provided by current cost.
Faithful representation: Measurement uncertainty	6.58A–6.58B	Discussion relocated from ‘relevance’ with minor consequential changes.