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This paper presents a staff redraft of parts of the measurement chapter of the Exposure Draft Conceptual Framework for Financial Reporting. *Agenda Paper 10G summarises the suggested changes and includes questions for Board members to discuss.*

In this redraft changes from the Exposure Draft are not marked. However, the paragraph numbers used in the Exposure Draft have been retained. Inserted paragraphs have been numbered with letters (e.g. 6.1A). Numbers of paragraphs that have been moved or deleted are omitted.

Chapter 6—Measurement

Introduction

6.1 Elements that are recognised in financial statements are quantified in monetary terms. This involves the selection of a measurement basis. A measurement basis is an identified attribute of an item being measured (for example, historical cost, fair value or fulfilment value). Applying a measurement basis to an asset or a liability creates a measure for that asset or liability and related income or expense.

6.2 This chapter discusses:

(a) measurement bases and the information that they provide (paragraphs 6.4–6.47);

(b) factors to consider when selecting a measurement basis (paragraphs 6.48–6.63).

(c) situations when more than one measurement basis provides relevant information (*not in this draft*); and

(d) measurement of equity *not in this draft*)).

6.3 Consideration of the objective of financial reporting, the qualitative characteristics of useful financial information 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.

6.3A This Chapter will assist in the identification of a measurement basis that may be used 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; or

(b) specifying a proxy measurement, for example where the proxy is likely to substantially achieve the measurement objective at less cost.

6.3B Cash-flow based measurement techniques are often used to estimate a measure on a particular measurement basis. They are discussed in paragraphs A1–A10.

Measurement bases and the information that they provide

6.4 Measurement bases can be categorised as:

(a) historical cost (paragraphs 6.6–6.17A); or

(b) current value (paragraphs 6.19–6.46).

Historical cost

6.6 Measures based on historical cost provide monetary information about assets, liabilities, income and expenses using information derived from the transaction or event that created them.

6.7 The historical cost of an asset at the time of the asset's acquisition or construction is the value of all the costs incurred in acquiring or constructing the asset, including both the consideration given and the transaction costs incurred. 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.

6.8 The historical cost of a liability at the time it is incurred is the value of the consideration received, comprising the consideration less the transaction costs incurred in taking it on. Reporting at historical cost a liability that has been recently assumed in exchange for consideration at the consideration received is justifiable as it is reasonable to assume, in the absence of evidence to the contrary, that the amount of the liability is no more than the amount received.

6.8A The carrying amount of a non-financial asset reported at historical cost is adjusted over time to depict, if and when applicable:

(a) the consumption of the economic resource that constitutes the asset (depreciation or amortisation); and

(b) the fact that part of the historical cost of the asset is no longer recoverable (impairment).

6.8B The carrying amount of a non-financial liability reported at historical cost is adjusted over time to depict, if and when applicable:

(a) accrual of interest;

(b) fulfilment of the liability; and

(c) any excess in the estimated cash outflows over the net consideration received (onerous liabilities). As a result, the carrying amount of a liability is increased when it becomes so onerous that the historical consideration is no longer sufficient to depict the requirement to fulfil the liability.

6.9 The subsequent carrying amount of financial assets and financial liabilities measured at historical cost reflects subsequent changes such as the accrual of interest, changes in the estimates of cash flows (including the impairment of financial assets) and payments or receipts. This process is sometimes referred to as amortised cost.

6.9A Historical cost does not reflect changes in prices, other than those caused by the factors identified in paragraphs 6.8A–6.9 above.

6.10 The derecognition of assets (liabilities) measured at historical cost results in the recognition as income or expenses of any difference between the carrying amount of the asset (liability) and any consideration received (paid) for that asset (liability).

6.11 The assets acquired and the liabilities incurred in transactions that involve no exchange do not have a readily identifiable initial cost. In such cases, current values are sometimes used as a proxy for cost (deemed cost) on initial measurement and that deemed cost is then used as a starting point for subsequent measurement. In such a circumstance, it may be necessary to confirm that the deemed cost of the asset is recoverable (or that the amount of the liability is not greater than its deemed cost).

6.12 The information provided by historical cost measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1, following paragraph 6.47. Paragraphs 6.12A–6.17A summarise the main advantages and disadvantages of historical cost.

6.12A Information about assets and liabilities measured at historical cost may be relevant as historical cost directly reflects the transactions undertaken by the entity. Because historical cost is adjusted to reflect consumption of assets and their impairment, and the carrying amounts of liabilities are increased where they are onerous, historical cost indicates that the entity's resources, net of the claims on the entity, are at least as great as the amount at which they are measured at the reporting date.

6.12B The consumption or derecognition of assets measured at historical cost results in an expense equal to the historical cost of the asset, and the satisfaction of liabilities measured at historical cost results in income equal to the historical cost of the liability. Any consideration receivable (payable) for that asset (liability) is generally recognised in the same period as that expense or income. As a result, the net income or expense from the sale of an asset is the difference between its historical cost and the consideration received (ie the margin). Similarly, when an entity satisfies a liability that is measured at historical cost, the net income or expense is the difference between the historical cost of the liability and the cost of fulfilling or satisfying it.

6.13 Income and expenses measured at historical cost may have predictive value. For example, for non-financial assets, information about the past consumption of assets (including services consumed) and the consideration received for them can be used as some of the inputs needed to predict future margins and hence an entity's prospects for future cash flows from the future supply of goods and services.

Income and expenses measured at historical cost may also have confirmatory value by providing feedback about previous estimates of cash flows or margins.

6.13A If financial assets and liabilities are measured at amortised cost, the financial statements report the contractual yield and cost of borrowing. This has predictive value as it may be used as one of the inputs to estimate future returns. It may also have confirmatory value by providing feedback about previous estimates of cash flows or of margins.

6.15 In many situations, it is simpler and less expensive to provide information about historical cost than information using current value measurement bases. In addition, measures prepared using the historical cost measurement basis are generally well understood and, in many cases, verifiable.

6.16 Estimating consumption and identifying impairment losses or onerous liabilities can be subjective. Hence, the historical cost of an asset or a liability can sometimes be as difficult to estimate as a current value. In addition, as noted in paragraph 6.11, historical cost can be difficult to determine when there is no observable transaction price for the asset or the liability being measured. For this reason, some amounts reported on historical cost basis may have such a high degree of measurement uncertainty that they may not provide a faithful representation of the financial position or performance of the entity.

6.17 Using the historical cost measurement basis, similar assets or liabilities that are acquired or incurred at different times can be reported in the financial statements at very different amounts. This can reduce comparability both between reporting entities and within the same reporting entity.

6.17A Because historical cost measures do not reflect changes in prices, they may not provide relevant information about assets, liabilities, income and expense if price changes are significant. For example, historical cost is unlikely to provide relevant information about a financial asset or financial liability that is a derivative.

Current value

6.19 Measures based on current value provide monetary information about assets, liabilities, income and expenses using information that is updated to reflect conditions at the measurement date. Because of the updating, current values capture any positive or negative changes, since the previous measurement date, in estimates of cash flows and other factors included in those current values (see paragraph 6.23).

6.20 Current value measurement bases include:

(a) current cost (see paragraphs 6.20A–6.20C)

(b) fair value (see paragraphs 6.21–6.33); and

(c) value in use for assets and fulfilment value for liabilities (see paragraphs 6.34–6.46).

Current cost

6.20A The current cost of an asset (liability) is the cost of (proceeds from) an equivalent asset (liability) at the measurement date. Current cost, like historical cost, is an entry value (ie it reflects values in the market in which the entity acquires the asset or incurs the liability). Hence, it is different from the current value measurement bases described in paragraphs 6.21–6.46, which are exit values.

6.20B Like historical cost, current cost provides information on the cost of consumption of an asset (or income from the satisfaction of liabilities) and hence the margin. The difference is that where current cost is used consumption (satisfaction) is reported at current prices (that is prices prevailing at the time of consumption (satisfaction) rather than when the asset (liability) was acquired (incurred)). This may be more relevant where price changes are significant as future cost of consumption (satisfaction) is more likely to resemble current prices than historical prices. The difficulty of using historical cost measures as inputs to predict future margins where price changes are significant is increased when, as is often the case, the user of the financial statements does not know when the assets (liabilities) were acquired.

6.20C There are, however, significant disadvantages in the application of current cost. These include:

(a) There is little information content in the aggregate change in the current cost of an asset or liability. In order to report the current cost of consumption (or income from satisfaction) it is necessary to disaggregate the change in the reporting period into the effect of changes in prices (sometimes referred to as holding gains and losses) and the current cost of consumption (satisfaction). This disaggregation is sometimes complex and requires the use of arbitrary assumptions.

(b) Application of current cost can be complex and subjective. For example, if prices are available only for new assets, the current cost of an asset might be found by adjusting the price of a new asset to reflect the current age and condition of the asset that is held by the entity. Furthermore, because of changes in technology and business practices, many assets would not be replaced with identical assets, so a further subjective adjustment to the price of a new asset would be required in order to estimate the current cost of the existing asset.

(c) If some, but not all, assets and liabilities are stated at current cost, the financial statements might lack coherence and hence understandability. This could give rise to measurement inconsistencies for related assets and liabilities, and hence result in financial statements that do not faithfully represent the entity's financial position and financial performance (see paragraph 6.58).

Fair value

6.21 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.

6.22 Fair value reflects the perspective of market participants. That is, the asset or the liability is measured using the same assumptions that market participants would use when pricing the asset or the liability if those market participants act in their economic best interest.

6.23 Fair value reflects the following factors:

(a) estimates of future cash flows.

(b) possible variations in the estimated amount and timing of future cash flows for the asset or the liability being measured, caused by the uncertainty inherent in the cash flows.

(c) the time value of money.

(d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium or risk discount). The price for bearing that uncertainty depends on the extent of that uncertainty. It also reflects the fact that investors would generally pay less for an asset (generally expect to receive more for taking on a liability) that has uncertain cash flows than for an asset (liability) whose cash flows are certain.

(e) other factors, such as liquidity, that market participants would take into account in the circumstances.

6.24 The fair value of an asset is the same as the fair value of the liability of the counterparty. The factors identified in paragraph 6.23 include credit risk, that is, the possibility that the obliged entity may fail to fulfil its obligations. Where the item is a liability of the entity, its own credit risk is included.

6.25 As noted in paragraph 6.23(d), the fair value of an asset or a liability reflects a risk premium. Thus, when an entity takes on a liability in a transaction that involves no exchange and measures it on initial recognition at fair value, the expense recognised at that date includes the risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Including the risk premium in the measure of the liability depicts the full burden of the liability. However, users may sometimes find it counterintuitive to recognise an initial expense including the risk premium, and then subsequently to recognise the same amount as income.

6.26 The fair value of:

(a) an asset is not increased by the transaction costs incurred when acquiring the asset. Nor is it decreased by the transaction costs that would be incurred on selling the asset.

(b) a liability is not decreased by the transaction costs arising when the liability is incurred. Nor is it increased by the transaction costs that would be incurred on transferring or settling the liability.

6.27 The information provided by the fair value measures of assets, liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1 following paragraph 6.47. Paragraphs 6.28–6.33 summarise the main advantages and disadvantages of fair value.

6.28 Information given about assets and liabilities when they are measured at fair value has predictive value, because fair value reflects expectations about the amount, timing and uncertainty of the cash flows (reflecting market participants’ expectations and priced in a manner that reflects their risk preferences). It may also have confirmatory value by providing feedback about previous estimates.

6.29 Income and expenses measured at fair value could be split in various ways to provide information with predictive and confirmatory value. For example, they could be split into:

(a) the return that market participants would have expected from holding the asset during the period;

(b) the difference between that return and the return generated by the entity’s actual use of the asset during the period (providing information about the efficiency with which the entity has used the asset); and

(c) the effect of changes in estimates of market participants' expectations about the amount, timing and uncertainty of future returns, combined with changes in estimates of market participants' risk preferences.

6.30 However, depending on the item that is being measured and the nature of the business activities conducted by the entity, users may not always find information about estimates of changes in expectations of market participants relevant. Hence, they may not always find income and expenses measured at fair value relevant. In particular, this may be the case when the business activities conducted by the entity do not involve selling the asset or transferring the liability; for example, if assets are held solely for use or to collect contractual cash flows, or if liabilities are to be fulfilled by the reporting entity itself.

6.31 Because fair value is determined from the perspective of market participants, instead of the perspective of the entity, and is independent of when the asset or the liability was acquired or incurred, identical assets will (subject to estimation error) be measured at the same amount. This can enhance comparability both between reporting entities and within the same reporting entity.

6.32 If the fair value of an asset or a liability can be observed in an active market, the process of fair value measurement is simple and easy to understand, and the fair value is verifiable. If fair value cannot be observed, valuation techniques (sometimes including the use of cash-flow-based measurements) may be needed to estimate that fair value. Depending on the techniques used:

(a) the estimation process may be costly and complex.

(b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process itself. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.

6.33 If an entity is estimating the fair value of a specialised item, there may sometimes be little reason for the entity to assume that market participants would use assumptions different from those that the entity itself uses. In that case, measurement from a market participant perspective and measurement from the entity's perspective are likely to produce similar measures.

Value in use and fulfilment value

6.34 Value in use and fulfilment value are entity-specific values. Value in use is the present value of the cash flows that an entity expects to derive from the continuing use of an asset and from its ultimate disposal. Fulfilment value is the present value of the cash flows that an entity expects to incur as it fulfils a liability.

6.35 Value in use and fulfilment value cannot be directly observed and are determined using cash-flow-based measurement techniques. In principle, value in use and fulfilment value reflect the same factors as described for fair value in paragraph 6.23, but are based on entity-specific assumptions instead of assumptions by market participants. In practice, to provide the most useful information, value in use and fulfilment value may sometimes need to be customised, for example, it may sometimes be appropriate:

(a) to use market participant assumptions about the time value of money or the risk premium; or

(b) to exclude from the fulfilment value the effect of the possibility of non-performance by the entity.

6.36 When an entity incurs a liability in a transaction that involves no exchange and measures it on initial recognition at the fulfilment value, the expense recognised at that date includes a risk premium. As the entity is subsequently released from risk, the liability is reduced and income is recognised. Users may sometimes find that effect counterintuitive (see paragraph 6.25).

6.37 Value in use reflects the present value of the transaction costs that the entity expects to incur on the ultimate disposal of the asset.

6.38 Fulfilment value not only includes the present value of the amounts to be transferred to the liability counterparty, but also the present value of the amounts that the entity expects to transfer to other parties to enable it to fulfil the liability. Thus, it also includes the present value of transaction costs (if any) that the entity expects to incur in undertaking transactions that enable it to fulfil the liability.

6.39 The information provided by value in use measures of assets, income and expenses and fulfilment value measures of liabilities, income and expenses in both the statement of financial position and the statement(s) of financial performance is summarised in Table 6.1, following paragraph 6.47. Paragraphs 6.40–6.46 summarise the main advantages and disadvantages of value in use and fulfilment value.

6.40 Value in use provides information about the present value of the estimated cash flows from the continued use of an asset and from its disposal at the end of its useful life. This information has predictive value and can be used in assessing the prospects for future cash flows, particularly if the asset will contribute to future cash flows by being used.

6.41 Fulfilment value provides information about the present value of the estimated cash flows to fulfil a liability. That information has predictive value; particularly if the liability will be fulfilled instead of transferred or settled by negotiation.

6.42 Updated estimates of value in use and fulfilment value, combined with information about actual cash flows, have confirmatory value because they provide feedback about previous estimates of value in use and fulfilment value.

6.43 Value in use and fulfilment value are determined using cash-flow-based measurement techniques. As noted in paragraph 6.32, depending on the techniques used:

(a) the estimation process can be costly and complex; and

(b) the inputs into the process may be subjective and it may be difficult to verify both the inputs and the validity of the process. As a consequence, entities may measure identical assets or liabilities at different amounts, which reduces comparability.

6.44 Because value in use and fulfilment value are determined from the perspective of the reporting entity, those measures could differ for identical assets and liabilities in different entities, arguably reducing comparability. In contrast, because fair value uses market participant assumptions, in theory, different entities should arrive at identical estimates of fair value for identical items.

6.45 For many assets that are used in combination with other assets, the value in use cannot be determined meaningfully for individual assets. Instead, the value in use is determined for a group of assets and the result is then allocated to individual assets. Hence, determining the value in use of an asset used in combination with other assets can be a costly and complex process and value in use may not be a practical measurement basis for periodic remeasurements of such assets. However, it may be useful for occasional remeasurements of assets (for example, when it is used in an impairment test to determine whether a historical cost measure is fully recoverable).

6.46 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.

Summary of information provided by different measurement bases

6.47 Table 6.1 summarises the information provided in the statement of financial position and the statement(s) of financial performance by the measurement bases described in paragraphs 6.6–6.46.

Table 6.1—Information provided by various measurement bases

Assets

	Historical cost	**Current cost**	**Fair value (market participant assumptions)**	**Value in use (entity-specific assumptions)**
Statement of financial position: Non-financial assets	Historical cost (including transaction costs) to the extent unconsumed and recoverable.	Current cost (including transaction costs) to the extent unconsumed and recoverable.	Price that would be received to transfer the asset, excluding transaction costs.	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 (after deducting present value of transaction costs on disposal).
Statement of financial position: Financial assets	Historical cost (including transaction costs) and accrued interest, to the extent uncollected and recoverable.	Current cost (including transaction costs) and accrued interest, to the extent uncollected and recoverable.	Price that would be received to transfer the asset, without deducting transaction costs.	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 (after deducting present value of transaction costs on disposal).
Income	Consideration received, including interest received on financial assets measured at historical prices.	Consideration received, including interest received on financial assets, measured at current prices. Holding gains.	Increases in fair value. May be disaggregated into (for example): (a) Market rate of return; (b) Difference between (a) and actual return; and (c) Changes in market participants' expectations.	Consideration received, including interest received on financial assets. Increases in value in use.
Expenses	Consumption of the asset (depreciation, impairment and derecognition) measured at historical prices. Selling expenses.	Consumption of the asset (depreciation, impairment and derecognition) measured at current prices. Selling expenses. Holding losses.	Decreases in fair value. May be disaggregated into (for example): (a) Market rate of return; (b) Difference between (a) and actual return; and (c) Changes in market participants'' expectations. Transaction costs on acquiring and selling the asset.	Consumption of the asset (depreciation, impairment and derecognition) measured at previous value in use. Decreases in value in use. Transaction costs on acquiring the asset.

Liabilities

	Historical cost	Current cost	Fair value (market participant assumptions)	Fulfilment value (entity-specific assumptions)
Statement of financial position: Non-financial liabilities	Historical cost (reduced by transaction costs), to the extent unfulfilled and increased by: (a) accrued interest; and (b) excess of estimated cash flows over consideration received.	Current cost (r reduced by transaction costs), to the extent unfulfilled and increased by: (a) accrued interest; and (b) excess of estimated cash flows over consideration received.	Price that would be paid to transfer the liability, excluding transaction costs.	Present value of cash flows estimated to arise in fulfilling the liability.
Statement of financial position: Financial liabilities	Historical cost (reduced by transaction costs) increased by accrued interest and excess of estimated cash flows over consideration received, to the extent unfulfilled.	Current cost (reduced by transaction costs) increased by accrued interest and excess of estimated cash flows over consideration received, to the extent unfulfilled.	Price that would be paid to transfer the liability, excluding transaction costs.	Present value of cash flows estimated to arise in fulfilling the liability.
Income	Fulfilment or release from the liability measured at historical prices.	Fulfilment or release from the liability measured at current prices. Holding gains.	Decreases in fair value. May be disaggregated into (for example): (a) Market rate of return; (b) Difference between (a) and actual return; and (c) Changes in market participants' expectations.	Fulfilment or release from the liability, measured at fulfilment value. Decreases in fulfilment value.
Expenses	Accrued interest on the liability, measured at historical prices.	Accrued interest on the liability, measured at current prices. Holding losses.	Increases in fair value. May be disaggregated into (for example): (a) Market rate of return; (b) Difference between (a) and actual return; and (c) Changes in market participants' expectations. Transaction costs on acquiring and selling the liability.	Accrued interest on the liability, measured at fulfilment value. Increases in fulfilment value. Transaction costs on acquiring the liability.

Factors to consider when selecting a measurement basis

6.48 The discussion in paragraphs 6.4–6.47 describes, for each measurement basis, the information it provides and its advantages and disadvantages. The following paragraphs discuss factors to be considered in selecting a measurement basis for an asset or a liability and the related income and expenses.

6.49 For information provided by a particular measurement basis to be useful to the users of financial statements, it must be relevant and it must faithfully represent what it purports to represent. In addition, the information provided should be, as far as possible, comparable, verifiable, timely and understandable.

6.49A As is explained in paragraph [2.21], the most efficient and effective process for applying the fundamental qualitative characteristics is to identify the information about an economic phenomenon that would be most relevant if it is available and can be faithfully represented. If that information is not available or cannot be faithfully represented, the next most relevant type of information is considered. Factors that affect the relevance of measures of assets,liabilities, income and expenses are discussed in paragraphs 6.54–6.54K; faithful representation is discussed in paragraphs 6.57–6.58, and the enhancing qualitative characteristics are discussed in paragraphs 6.59–6.63.

6.49B The relative importance of each of the factors will depend upon facts and circumstances. In most cases, no one factor, considered in isolation, will be conclusive as to the measurement basis that should be selected.

6.49C When selecting a measurement basis, it is important to consider the information that a measurement basis will produce in both the statement of financial position and the statement(s) of financial performance. Table 6.1 at paragraph 6.47 summarises the information provided in the statement of financial position and the statement(s) of financial performance.

6.50 As with all other areas of financial reporting, cost constrains the selection of a measurement basis. Hence, the benefits of the information provided to the users of financial statements by a particular measurement basis must be sufficient to justify the cost of providing that information.

6.51 Measures of assets, liabilities, income and expenses are used in the measurement of recognised items, and in presentation and disclosure. The following discussion on the factors to be considered in selecting a measurement basis focuses on the selection for recognised items. Nevertheless, some of that discussion may also apply to the selection of a measurement basis for disclosure in the notes to the financial statements of measures of unrecognised assets and unrecognised liabilities and changes in them. However, in some cases relevant information is disclosed in the notes to the financial statements using a different measurement basis from that used in the statement of financial position and the statement(s) of financial performance (see paragraph 6.75) *[not in this draft]*.

6.52 Paragraphs 6.54A–6.54K discuss the factors to be considered in selecting a measurement basis by reference to the qualitative characteristics of useful financial information. Paragraphs 6.64–6.73 *[not in this draft]* discuss additional factors to consider in selecting a measurement basis on initial recognition. Initial measurement and subsequent measurement cannot be considered separately. If the initial measurement basis and subsequent measurement basis are not consistent, income and expenses will be recognised solely because of the change in measurement basis. Recognising such income or expenses might appear to depict a transaction or other event when, in fact, no such transaction or event has occurred. Hence, the choice of measurement basis for an asset or a liability and the related income or expenses is determined by considering both the initial measurement and the subsequent measurement.

Relevance

6.54 It is important to consider the following factors when considering the relevance of a measurement basis for an asset or a liability and the related income and expenses:

(a) how that asset or liability contributes to future cash flows; and

(b) the characteristics of the asset or the liability.

The contribution of the asset or liability to future cash flows

6.54A As noted in paragraph [1.14], some cash flows are generated directly by economic resources: in other cases, resources are used in combination to generate cash flows, and thus generate cash flows indirectly. This will depend, in part on the nature of the business activities conducted by the entity.

6.54B For assets and liabilities that produce cash flows directly, such as assets that are capable of being sold independently, the most relevant measurement basis is likely to be one that reflects the present value of the future cash flows: that is, fair value or value in use (for liabilities, fulfilment value).

6.54C Where a business activity involves the use of several resources that generate cash flows indirectly, by being used in combination to produce and market goods or services to customers, a cost-based measurement basis is likely to be relevant. The expense reported will then reflect the cost of assets consumed in a period, and a comparison of that expense with the revenue of the period provides information on the margins achieved in the period. Information about margins can be used as some of the inputs needed to predict future margins and hence in assessing the entity's prospects for future cash flows (see paragraph 6.12B–6.13 above). Assets held for use in such an activity are unlikely to be sold independently, so cost-based information may be more relevant than fair value.

6.54D Liabilities incurred in order to raise finance cannot be identified with any specific business activity and often cannot be transferred or settled before maturity. Because they are unlikely to be transferred or settled before maturity, cost-based information may be more relevant than fair value.

6.54E Where financial assets and financial liabilities are held as part of a business activity that is managed with a view to collecting contractual cash flows, a cost-based measurement basis may be relevant as it provides information on the margin between the contractual yield and the entity's cost of funds.

6.54F Where inventory is held as part of a business activity that involves the production of goods for customers, it does not generate cash flows directly as sale requires the use of economic resources in selling activities and, until the sale is achieved, the entity is subject to the risk of not finding a customer. Hence, historical cost is likely to provide relevant information. In contrast, commodity broker-traders, for example, may have ready access to an exchange market, so no significant selling effort is required and there is no significant risk of not finding a customer. Such inventory is therefore capable of being sold independently and fair value is likely to be more relevant than historical cost.

6.54G Where a customer pays in advance for goods and services to be provided at a later date, a liability arises (see paragraph [4.42]). A cost-based measurement basis is likely to be relevant for such a liability, as it reflects the amount due to the customer. Measuring the liability at cost also results in income being reported only in the period in which the goods or services are provided, and that income is measured at the transaction price.

Characteristics of the asset or liability

6.54H The relevance of a measurement basis will also depend on the characteristics of the asset or liability. For assets and liabilities that are subject to variability in their cash flow, or whose value is sensitive to market factors or other risks, a current value such as fair value or value in use is likely to be more relevant than a cost-based measure.

6.54I If the cash flows of a financial asset or liability are variable, amortised cost may not provide relevant information. Amortised cost allocates interest revenue or expense to the relevant period, based on contractual cash flows. If the cash flows of a financial asset or financial liability are variable—that is they do not comprise simply principal and interest—amortised cost cannot be applied.

6.54J If the value of an asset or liability is sensitive to market factors or other risks, its historical cost might be significantly different from the value of the asset or liability at the reporting date. The current value of assets or liabilities at the reporting date would be most relevant in providing information that helps users to assess the features identified in paragraph [1.13]:

(a) the reporting entity's financial strengths and weaknesses;

(b) the entity's liquidity and solvency;

(c) the entity's need for additional financing and how successful it is likely to be in obtaining that financing; and

(d) management's stewardship of the reporting entity's economic resources.

6.54K Furthermore, if historical cost is used, changes in value would not be reported when the value of the asset or liability changes, but only when it is disposed of (derecognised). This could be incorrectly interpreted as implying that all the income or expenses arose in the period of disposal (derecognition), rather than in the periods during which the asset or liability was held. Also, measurement at historical cost would fail to communicate the entity's exposure to risk arising from holding the asset or liability.

Faithful representation

6.57 As noted in paragraphs [2.15] and [2.19], a perfectly faithful representation is free from error, but this does not mean that measures must be perfectly accurate in all respects. For example, an estimate of an unobservable price can be faithfully represented if it is described as being an estimate, if the nature and limitations of the estimating process are explained and if no errors have been made in selecting and applying the process for developing the estimate.

6.58 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (an 'accounting mismatch'). Measurement inconsistencies can result in financial statements that do not faithfully represent the entity's financial position and financial performance. Consequently, in some circumstances, using a similar measurement basis for related assets or liabilities may provide more useful information for users of financial statements than using dissimilar measurement bases. This may be particularly likely when the cash flows from one item are contractually linked to the cash flows from another item.

Measurement uncertainty

6.58A Measurement uncertainty affects whether information provided by a measurement basis provides a faithful representation of the financial position and performance of an entity (see paragraphs [2.12–2.13)]. A high level of measurement uncertainty does not prevent the use of a measurement basis that provides the most relevant information. However, in some cases, the level of measurement uncertainty is so high that a different measurement basis may provide more relevant information. Moreover, if no measurement basis for an asset or a liability would provide relevant information, it is not appropriate to recognise the asset or the liability (see paragraph [5.13]).

6.58B Measurement uncertainty is not the same thing as outcome uncertainty. For example, if the fair value of an asset is observable in an active market, no uncertainty is associated with the measurement of that fair value, even though it is uncertain how much cash the asset will ultimately produce. Nevertheless, outcome uncertainty may sometimes contribute to measurement uncertainty. For example, there may be a high level of uncertainty about the cash flows that a unique asset will produce (outcome uncertainty) and estimating a current value of that asset may depend on a model whose validity is untested and that requires inputs that are difficult to verify.

Enhancing qualitative characteristics

6.59 The enhancing qualitative characteristics of comparability, verifiability and understandability also have implications for the selection of a measurement basis. However, the enhancing qualitative characteristic of timeliness has no specific implications for measurement.

6.60 Comparability implies using measurement bases that are the same between periods and between entities. Reducing the number of measurement bases used contributes to comparability.

6.61 Verifiability implies using measurement bases that result in measures that can be independently corroborated either directly (such as by observing prices) or indirectly (such as by checking inputs to a model). If a particular measure cannot be verified, disclosures may be needed in the notes to the financial statements to enable users of financial statements to understand the assumptions used. In some such cases, it may be necessary to select a different measurement basis.

6.62 Understandability depends partly on the number of different measurement bases used and on whether they change over time. In general, if the number of measurement bases used in a set of financial statements increases, the resulting information becomes more complex (and, hence, less understandable), and the totals or subtotals in the statement of financial position and the statement(s) of financial performance become less meaningful. However, it could be appropriate to increase the number of measurement bases used if that is necessary to provide more relevant information.

6.63 A change in measurement basis can make financial statements less understandable. However, a change may be justified if other factors outweigh the reduction in understandability; for example, if the change results in more relevant information. In such cases, disclosures may be needed in the notes to the financial statements to enable users to understand any income or expenses recognised as a result of the change in measurement basis.

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