

Conceptual Framework Project
Phase C: Measurement
Milestone I Summary Report—Inventory and Definitions of Possible Measurement Bases

This report summarizes and explains the tentative FASB and IASB decisions in the first milestone of the measurement phase of their conceptual framework (CF) project. The objective of the first milestone was to inventory and define the measurement basis candidates that might be used in financial statements. This summary begins with a brief overview of the conceptual framework project in general, then explains the purpose and objectives of the measurement phase in particular, and closes by summarizing and explaining the decisions reached in the first measurement milestone.

This is the first of two reports planned for the measurement phase; the second report will explain the results of the Boards' deliberations of Milestone II, the objective of which is to evaluate the measurement basis candidates from Milestone I. Neither this report nor the one that will follow is a formal document intended to solicit public comment. The Boards will issue a discussion paper seeking formal comment on all of the tentative conclusions reached in the measurement phase in 2008 or early 2009. All references to the Boards' agreements, conclusions, or decisions should be interpreted as tentative and subject to change.

Overview

The Conceptual Framework

The *conceptual framework* establishes the system of concepts that underlie financial reporting; it provides a foundation in the form of objectives of financial reporting and characteristics of reported financial information, as well as related definitions and criteria. These concepts are the tools the Boards use in setting accounting standards; they serve as objective criteria to ensure the relevance of the information provided by standards and the consistency of accounting standards with one another.

Both the FASB and IASB have an existing conceptual framework. However, both are around 20 years old. In 2004, the Boards added to their agendas a joint agenda project to converge, refine, and update their existing conceptual frameworks and to provide additional guidance in certain areas. The goal of the project is to create a complete, common framework that both Boards will use to develop and revise their accounting standards. They are conducting the project in eight phases; “Phase C” will address a new framework for accounting measurement.

The Need to Readdress Measurement

Measurement is a critical aspect of financial reporting; however, it is also one of the most under-developed areas of the current conceptual frameworks. For example, in the FASB framework, FASB Concept Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, simply provides a list of measurement bases (or attributes) used in present practice and indicates that the use of different bases is expected to continue. Similarly, the IASB Framework merely lists examples of measurement bases that standard setters might consider.

Neither of the current frameworks provides any analysis of the strengths and weaknesses of the various measurement bases, nor do they offer any guidance on choosing among the listed bases or considering other alternatives. The overall objective of the new measurement framework is to fill in these gaps in coverage—so that standard-setters will have clear, up-to-date guidance to use in determining the measurement requirements for specific accounting standards.

The Measurement Phase

Because of the inherent complexity of measurement issues, the Boards decided to undertake the measurement phase using a building block approach, with each building block representing a separate milestone. The objectives of each milestone are explained below. Appendix A provides a list of 15 issues (five issues per milestone) that the Boards agreed to consider during their deliberations.

Milestone I—Inventory and Define Possible Measurement Bases (completed spring 2007): The objective of Milestone I was to inventory and define potentially suitable measurement bases, building off previous work—including past frameworks of the IASB, FASB, and other standards setters and other work, such as the IASB Discussion Paper, *Measurement Bases for Financial Reporting – Measurement on Initial Recognition*, issued in November 2005.

Milestone II—Evaluate Measurement Basis Candidates: In Milestone II, the Boards will evaluate each measurement basis candidate’s potential to provide decision-useful information by testing each basis candidate against the qualitative characteristics of relevance, faithful representation, verifiability, comparability, understandability, and timeliness.

Milestone III—Draw Conceptual Conclusions and Address Practical Issues: The objective of Milestone III is to draw conceptual conclusions that build off the findings in Milestones I and II, and address practical measurement issues that the Boards encounter when developing standards. For example, this phase might provide guidance that the Boards can use when practical considerations prevent the straightforward application of a conceptually desirable basis. The Boards will also consider whether use of a single measurement basis would satisfy the needs of financial statement users or if some combination of bases is needed. They will also address any measurement issues remaining after Milestones I and II (and not otherwise assigned to any other phases of the project). At the conclusion of Milestone III, the Boards will construct a new framework for accounting measurement.

Summary of the Milestone I Deliberations

The following is a summary of the Boards’ tentative decisions on Milestone I issues and a brief explanation of the reasoning behind them.

Issue 1: What are the measurement basis candidates?

The Boards agreed to the following set of nine measurement basis candidates:

1. Past entry price
2. Past exit price
3. Modified past amount
4. Current entry price
5. Current exit price
6. Current equilibrium price
7. Value in use
8. Future entry price
9. Future exit price.

Appendix B lists the nine measurement basis candidates, along with their variations, and classifies them according to time frame (that is, whether they provide information primarily about the *past*, *present*, or *future*). Some of these measurement bases are currently used in practice, and some are proposed (for example, *current equilibrium price*). Some of the candidates have variations, but the Boards agreed to focus on the **primary** measurement bases rather than on the variations during the remainder of the measurement phase. If a subsequent analysis suggests that a variation should be singled out, the staff can do so for that particular analysis.

While establishing the inventory of measurement bases, the staff noticed two recurring problems. The first was a language problem. The staff discovered that, in some instances, multiple terms were used to describe a single measurement basis; in other instances, one term was used to refer to a variety of different bases. These types of language problems have contributed to miscommunication and misunderstandings among the Boards, staff, and constituents in their discussions about measurement. To counter this problem, the Boards needed to develop a common language to use in their discussions. They agreed to select a set of measurement basis terms that would include all the measurement basis concepts in the original inventory—but identify only **one term** to describe **each concept**.

The second problem involved the use of measurement basis candidates in existing accounting standards. The Boards noted that the same measurement basis concept could be used differently in different standards, since a particular standard could limit the way a measurement basis candidate could be measured, estimated, or applied. Also, some standards combine the use of certain measurement basis candidates (such as the lower-of-cost-or-market rule). If the Boards accepted each particular application (or combination

of measurement basis concepts) as a separate candidate, it could overburden, and unduly complicate, the evaluation process. Therefore, the Boards agreed to consider only the separate, underlying concepts as measurement basis candidates.

Some participants, as well as observers, in the Milestone I deliberations noted that the list of measurement basis candidates does not seem to fit together into a complete, logical whole. While acknowledging that the list does not seem to follow a specific pattern, the staff believes that this is somewhat inevitable: the list must be comprehensive enough to include measurement basis terms representing current practice and also those that represent longstanding alternatives. If the staff had constructed the list based on a particular theory, it likely would have eliminated some candidates from the outset. Also, the staff believes that current practice alone is so diverse that it could not be the source of a logical list of candidates.

Two of the most talked-about measurement basis terms—historical cost and fair value—are noticeably excluded from the list. That is because there is no common understanding of those terms, and their use often leads to miscommunication and misunderstanding. Nevertheless, historical cost and fair value have not been overlooked: The measurement basis candidates relating to the **past** (*past entry price*, *past exit price*, and *modified past amount*) together constitute the notion of historical cost. Similarly, the list of candidates relating to the **present** (*current entry price*, *current exit price*, *current equilibrium price*, and *value in use*) encompasses the various notions of fair value.

Issue 2: How are the measurement bases defined?

Appendix C provides two definitions for each measurement basis candidate—one from the perspective of an asset and one from the perspective of a liability. It also provides examples and terms used as synonyms. In the case of the various entry and exit prices, the Boards agreed that the definitions should emphasize the **concepts** behind entry and exit prices, without respect to the way in which those prices may be measured. For example, the *current entry price* of an asset is defined as the price that an entity would have to pay currently in exchange for purchasing its asset. However, the way that price is measured depends on the particular situation. If an entity acquires a new asset, the current entry

price may be measured by using the entity's transaction price for the asset. If the entity already owns the asset, the entry price for that asset may be measured by reference to the price paid by a third party to acquire an identical asset at the measurement date. In either case, the concept of the current entry price remains the same—regardless of the source of the transaction used to measure it.

Issue 3: What are the basic properties of the measurement bases?

The Boards have agreed that most of the measurement basis candidates are either prices or values. In addition, each candidate primarily provides information about a specific time frame—either past, present, or future.

Of the nine candidates, seven are prices (*past entry price, past exit price, current entry price, current exit price, current equilibrium price, future entry price, and future exit price*), one is a value (*value in use*), and one is neither a price nor a value (*modified past amount*). Both price and value are assessments of economic utility or worth. However, *values* are specific to an individual or entity, whereas *prices* are determined by markets and may not reflect the economic worth of an asset or liability to any one individual or entity. Because prices and values are basic components of economic decisions, the Boards agreed that it would be helpful to identify whether the basis candidates were prices, values, or neither.

In addressing the time orientation, the Boards agreed that three of the candidates (*past entry price, past exit price, and modified past amount*) relate to the past time frame, four candidates relate to the present time frame (*current entry price, current exit price, current equilibrium price, and value in use*), and two relate to the future time frame (*future entry price and future exit price*). In most cases, the names of the basis candidates identify the time frame; the one exception is *value in use*, which is included in the present time frame.

Issue 4: Are the measurement bases appropriate for both assets and liabilities?

During Milestone I deliberations, the Boards concluded that all of the primary measurement basis candidates could be considered from the perspectives of both assets and liabilities. However, the Boards agreed to retain some traditional terminology

differences relating to assets and liabilities to facilitate understanding of each of the measurement basis candidates. For example, assets are described as **purchased** or **acquired**, whereas liabilities are **incurred**.

While there are some variations of *current entry price* that traditionally have been discussed only in terms of assets (see 4.b.i through 4.b.iv in Appendix B or C), the primary concept of entry price applies to both assets and liabilities; it is this primary concept that will be evaluated.

Issue 5: Should any measurement basis candidates be eliminated from consideration for evaluation in Milestone II?

The Boards decided not to eliminate any of the measurement basis candidates agreed upon by the end of Milestone I prior to the evaluation process in Milestone II. However, the list of nine candidates is considerably shorter than the list of candidates originally presented to the Boards during the early part of Milestone I. At that time, the staff responded to Board and constituent requests for reduced complexity by regrouping and renaming the original list of measurement basis candidates. They also eliminated some terms that were proposed only for liabilities, but the concepts associated with those terms were not removed; they were simply folded into larger concepts that include both assets and liabilities.

The Boards also eliminated the term *deprival value* from the original list of measurement basis candidates, as they tentatively agreed that deprival value is not a measurement basis in itself. Rather, it is a decision rule for selecting from among a group of measurement bases under certain conditions. The Boards agreed that it is sufficient that the remaining measurement basis candidates include the terms that make up the deprival value decision rule (namely *entry price*, *value in use*, and *exit price*).

Appendix A

Conceptual Framework Project Measurement Phase Issues

Milestone I: Measurement Bases—Definitions & Properties

- M01: What are the measurement basis candidates?
- M02: How are the measurement bases defined?
- M03: What are the basic properties of the measurement bases?
- a. How does each basis relate to prices and values, the building blocks of economic decisions?
 - b. What is the basic time orientation of each measurement basis?
- M04: Are the measurement bases appropriate for both assets and liabilities?
- M05: Should any measurement basis candidates be eliminated from consideration for evaluation in Milestone II?

Milestone II: Measurement Bases—Evaluation Using Qualitative Characteristics

- M06: Are the measurement bases relevant to the economic decisions of users of general purpose financial reports? Would their use provide confirmatory or predictive value and contribute to timeliness of information in financial reports?
- M07: Can the measurement bases be used to create faithful representations in financial reports? Would those representations be verifiable and neutral? Would they contribute to completeness of information in financial reports?
- M08: Would using the measurement bases contribute to comparability?
- M09: Would using the measurement bases contribute to understandability?
- M10: Are there concepts in addition to the qualitative characteristics that should be used to evaluate the measurement bases? (For example, capital maintenance and scientific measurement concepts) If so, how do the bases fare against them?

Milestone III: Measurement Bases—Conclusions and Application

- M11: Given the individual evaluations in Milestone II, how do the measurement bases compare with one another? Can they be ranked according to their overall satisfaction of the qualitative characteristics?
- M12: Should one measurement basis be used for all financial statement purposes, or could different bases be used for different purposes (for example, initial vs. subsequent measurement, assets vs. liabilities, and different types of assets or liabilities)?
- M13: Should the same basis (bases) used for financial statements also be used for other aspects of financial reporting, or could different bases be used outside the financial statements?
- M14: What are the practical problems of using the selected basis (bases)? Should the problems preclude their use in some or all situations? Are there ways to address those problems without diminishing the relevance, representational faithfulness, comparability, and understandability of financial reporting representations that use the basis (bases)?
- M15: What can standard setters, preparers, and auditors do to improve the quality of accounting measurements that use the selected basis (bases)?
-

Appendix B

Measurement Basis Candidates by Time Frame With Their Variations

PAST

1. *Past entry price*
 - a. without related prices
 - b. with related prices
2. *Past exit price*
 - a. without related prices
 - b. with related prices
3. *Modified past amount*
 - a. accumulated
 - b. allocated
 - c. amortized
 - d. combined

PRESENT

4. *Current entry price*
 - a. without related prices
 - b. with related prices
 - i. identical replacement
 - ii. identical reproduction
 - iii. equivalent replacement
 - iv. productive capacity replacement
5. *Current exit price*
 - a. without related prices
 - b. with related prices
6. *Current equilibrium price*
7. *Value in use*

FUTURE

8. *Future entry price*
 - a. without related prices
 - b. with related prices
9. *Future exit price*
 - a. without related prices
 - b. with related prices

Appendix C

Definitions of Measurement Basis Candidates Including Examples and Terms Used as Synonyms

Measurement Basis	Definition	Terms Used As Synonyms
PAST		
1. Past entry price	<p>a. Without related prices</p> <p><i>Asset:</i> The price that an entity would have had to pay in the past in exchange for purchasing its asset, ignoring any prices it would have had to pay for acquisition-related goods or services.</p> <p><i>Example: The amount that an entity would have had to pay in the past to purchase an office computer, ignoring any sales tax or VAT, and delivery or shipping charges.</i></p> <p><i>Liability:</i> (1) The price that an entity would have received in the past in exchange for incurring its liability, ignoring the prices it would have had to pay for incurrence-related goods or services, or (2) an amount imposed in the past for incurring a non-exchange liability.</p> <p><i>Example: The proceeds that an entity would have received in the past from issuing a corporate bond, ignoring underwriting costs.</i></p>	<p>Historical cost Past purchase price</p> <p>Historical cost Historical proceeds</p>

Measurement Basis	Definition	Terms Used As Synonyms
PAST		
3. Modified past amount	<p>a. Accumulated</p> <p><i>Asset:</i> The sum of all entry prices paid in the past to assemble, construct, or augment an asset over an extended period of time, including the prices paid for acquisition-related goods or services.</p> <p><i>Example: The accumulation of all amounts that were paid over a three-year period to construct an office building.</i></p> <p><i>Liability:</i> The sum of all prices received in the past in exchange for incurring multiple obligations within a single liability or incrementally increasing an existing single-obligation liability over an extended period of time, net of the prices paid for incurrence-related goods or services.</p> <p><i>Example: The total amount that was drawn down on a construction loan over a three-year period, net of the payments for loan origination fees.</i></p> <p>b. Allocated</p> <p><i>Asset:</i> The amount assigned to an asset after allocating a past entry price to multiple items.</p> <p><i>Example: The amount that was assigned to land in the past purchase of land and a building for a single price.</i></p>	<p>Historical cost</p> <p>Historical cost Historical proceeds</p> <p>Historical cost Allocated cost</p>

Measurement Basis	Definition	Terms Used As Synonyms
PAST		
3. Modified past amount (continued)	<p>Liability: The amount assigned to a liability after allocating a past entry price to multiple items.</p> <p><i>Example: The amount that was assigned to a bond in the past issuance of the bond and detachable stock purchase warrants for a single proceeds amount.</i></p>	Historical cost Historical proceeds
	<p>c. Amortized</p> <p>Asset: The remainder of an asset's original past entry price or subsequent past exit price after assigning some of that price to subsequent accounting periods, according to an accounting rule for amortization or depreciation.</p> <p><i>Example: The depreciated cost of a vehicle, using straight-line depreciation.</i></p> <p>Liability: The remainder of a liability's original past entry price or subsequent past exit price after assigning some of that price to subsequent accounting periods, according to an accounting rule for amortization.</p> <p><i>Example: The amortized proceeds of a corporate bond issue sold at a premium, using straight-line amortization.</i></p> <p>d. Combined</p> <p>Asset: The amount assigned to an asset through a combination of accumulation, allocation, and/or amortization of past prices.</p>	Historical cost Depreciated cost Amortized cost Historical cost Amortized cost Amortized proceeds Historical cost

Measurement Basis	Definition	Terms Used As Synonyms
PAST		
3. Modified past amount (continued)	<p><i>Example: The amount assigned to an asset that was constructed over time, where allocations of overhead costs were made to the asset, and the asset has been depreciated using straight-line depreciation.</i></p> <p>Liability: The amount assigned to a liability through a combination of accumulation, allocation, and/or amortization of past prices.</p> <p><i>Example: The amortized proceeds of a corporate bond issue sold at a premium, using straight-line amortization, where the bond had been sold with warrants and some of the proceeds were allocated to the warrants.</i></p>	Historical cost Historical proceeds

Measurement Basis	Definition	Terms Used As Synonyms
PRESENT		
4. Current entry price	<p>a. Without related prices</p> <p><i>Asset:</i> The price that an entity would have to pay currently in exchange for purchasing its asset, ignoring any prices it would have to pay for acquisition-related goods or services.</p> <p><i>Example: The amount that an entity would have to pay currently to purchase its headquarters building, ignoring attorneys' fees and closing costs.</i></p> <p><i>Liability:</i> The price that an entity would receive currently in exchange for incurring its liability, ignoring any prices it would have to pay for incurrence-related goods or services; or an amount that would be imposed on an entity currently for incurring the entity's non-exchange liability.</p> <p><i>Example: The amount that a bank would receive currently from a depositor for one of its existing certificates of deposit, ignoring the price of the bank's gift to the depositor for opening the account.</i></p> <p>b. With related prices</p> <p><i>Asset:</i> The price that an entity would have to pay currently in exchange for purchasing its asset plus any prices it would have to pay for acquisition-related goods or services.</p> <p><i>Example: The amount that an entity would have to pay currently to purchase its headquarters building, including attorneys' fees and closing costs.</i></p>	<p>Current cost Market price Market value</p> <p>Consideration amount Current equivalent proceeds Current proceeds</p> <p>Current cost</p>

Measurement Basis	Definition	Terms Used As Synonyms
PRESENT		
4. Current entry price (continued)	<p>i. Identical replacement The current entry price of replacing an existing asset with an identical one by purchase.</p> <p>ii. Identical reproduction The current entry price of replacing an existing asset with an identical one by reproduction</p> <p>iii. Equivalent replacement The current entry price of replacing an existing asset with an equivalent asset.</p> <p><i>Example: The current entry price to replace a used Nikon microscope with a used Leica microscope with the same power and features.</i></p> <p>iv. Productive capacity replacement The current entry price of replacing the productive capacity of an existing asset with the most current technology available.</p> <p><i>Example: The current entry price to replace an air conditioning unit with one that has the same cooling capacity but is more energy efficient.</i></p> <p>Liability: The price that an entity would receive currently in exchange for incurring its liability less any prices it would have to pay for incurrence-related goods or services.</p> <p><i>Example: The amount that a bank would receive currently from a depositor for one of its existing certificates of deposit, net of the price of the bank's gift to the depositor for opening the account.</i></p>	<p>Replacement cost</p> <p>Reproduction cost</p> <p>Replacement cost</p> <p>Replacement cost</p> <p>Replacement cost</p> <p>Current proceeds Net proceeds</p>

Measurement Basis	Definition	Terms Used As Synonyms
PRESENT		
5. Current exit price	<p>a. Without related prices</p> <p><i>Asset:</i> The price that an entity would receive currently in exchange for selling its asset, ignoring any prices it would have to pay for disposition-related goods or services.</p> <p><i>Example: The amount that an entity would receive currently from selling a parcel of land, ignoring an appraisal fee and a real estate transfer tax.</i></p> <p><i>Liability:</i> The price that an entity would have to pay currently in exchange for extinguishing its liability, ignoring any prices it would have to pay for extinguishment-related goods or services.</p> <p><i>Example: The amount that an entity would have to pay currently to pay off a mortgage loan, ignoring an early payment penalty.</i></p> <p>b. With related prices</p> <p><i>Asset:</i> The price that an entity would receive currently in exchange for selling its asset less any prices it would have to pay for disposition-related goods or services.</p> <p><i>Example: The amount that an entity would receive currently from selling a parcel of land, net of an appraisal fee and a real estate transfer tax.</i></p>	<p>Fair value Market price Market value</p> <p>Current proceeds Current settlement value</p> <p>Current cash equivalent Current exit value Current market value (Net) realizable value</p>

Measurement Basis	Definition	Terms Used As Synonyms
PRESENT		
7. Value in use	<p>Asset: The value that an entity places on its own asset. In its most sophisticated form, the amount of discounted net cash flow that the entity expects to receive from using its asset, including cash flow from the asset's eventual disposition.</p> <p><i>Example: The forecast future cash flows from using a printing press (including cash inflows from printing revenues and the sale of the press at the end of its use, as well as cash outflows for supplies, repairs, and maintenance), discounted at a rate equal to the entity's cost of capital and netted.</i></p> <p>Liability: The value that an entity places on its own liability. In its most sophisticated form, the amount of discounted net cash flow that the entity expects to pay for having incurred its liability, including cash outflows for carrying costs and for the liability's eventual extinguishment.</p> <p><i>Example: The forecast future cash flows for carrying a pension liability (including cash outflows for pension administration and payments to pensioners), discounted at a rate equal to the entity's cost of capital.</i></p>	<p>Discounted value of future cash flows Investment value Present value Present value of future cash flows</p> <p>Discounted value of future cash flows Present value Present value of future cash flows</p>

Measurement Basis	Definition	Terms Used As Synonyms
FUTURE		
9. Future exit price (continued)	<p>b. With related prices</p> <p>Asset: The price that an entity would receive in the future in exchange for selling its asset less any prices it would have to pay for disposition-related goods or services.</p> <p><i>Example: The amount that an entity forecasts it would receive from the sale of its patent five years from now, net of the entity's forecast legal fees and intangibles transfer tax.</i></p> <p>Liability: The price that an entity would have to pay in the future in exchange for extinguishing its liability plus any prices it would have to pay for extinguishment-related goods or services.</p> <p><i>Example: The amount that an entity forecasts it would have to pay to satisfy a court judgment next year in a lawsuit that the firm expects to lose, including court and attorneys' fees.</i></p>	<p>Future exit value Net market value Net realizable value Net selling value</p> <p>Expected value Expected value in due course of business Non-discounted amount of expected cash outlay</p>