FASB **EXPOSURE DRAFT**

*Proposed Statement of Financial Accounting Concepts*

Issued: December 21, 2023
Comments Due: March 20, 2024

# Concepts Statement No. 8, Conceptual Framework for Financial Reporting

## Chapter 6: Measurement

The Board issued this Exposure Draft to solicit public comment on a proposed Statement of Financial Accounting Concepts. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2023-ED700, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

**Notice to Recipients of This Exposure Draft of a Proposed Statement of Financial Accounting Concepts**

The Board invites comments on all matters in this Exposure Draft until March 20, 2024. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2023-ED700
- Sending a letter to "Technical Director, File Reference No. 2023-ED700, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference portion of its website.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Statement of Financial Accounting Concepts No. 8

# Conceptual Framework for Financial Reporting

## Chapter 6: Measurement

December 21, 2023

Comment Deadline: March 20, 2024

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# Preface

## Background

P1. The Financial Accounting Standards Board (FASB or Board) issued its first Concepts Statement in 1978 and issued six more by 2000. In 2004, the International Accounting Standards Board (IASB) and the FASB (the Boards) began a joint project to revise and converge their conceptual frameworks. The result of that joint project was FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting*, and *Chapter 3, Qualitative Characteristics of Useful Financial Information*. In late 2010, the Boards decided to postpone further action on their respective conceptual frameworks until after the completion of a number of joint projects and ultimately agreed to discontinue the effort to work on their frameworks on a joint basis.

P2. In January 2014, the FASB reactivated its conceptual framework project. This Exposure Draft, which would become Chapter 6 of Concepts Statement 8, addresses matters relating to the measurement of items recognized in financial statements.

## Authoritative Status of the Conceptual Framework

P3. Paragraph 105-10-05-3 of the *FASB Accounting Standards Codification*® states that FASB Concepts Statements are not authoritative. Some standards are inconsistent with the Concepts Statements. This chapter or other chapters of Concepts Statement 8 do not override authoritative standards. If accounting for a transaction or event is not specified in authoritative generally accepted accounting principles (GAAP), an entity first must consider accounting principles for similar transactions or events within authoritative GAAP and then consider nonauthoritative guidance from other sources (including Concepts Statement 8).

## How This Chapter of the Conceptual Framework Would Be Used

P4. This chapter of Concepts Statement 8 would be similar to the rest of the framework in that it establishes concepts that the Board would use in developing standards of financial accounting and reporting. In particular, this chapter would provide the Board with a framework for conceptual matters relating to the measurement of items recognized in financial statements. This chapter would provide the Board with a framework for developing standards in meeting the objective of financial reporting that enhances the understandability of information to existing and potential investors, lenders, donors, and other resource providers of a reporting entity.

# Summary and Questions for Respondents

## Summary

### Introduction to the Conceptual Framework

S1. The Conceptual Framework establishes the concepts that underlie financial reporting. The Conceptual Framework is a coherent system of concepts that flow from the objective of general purpose financial reporting. The fundamental concepts address the selection of transactions and other events and circumstances to be faithfully represented in general purpose financial reporting. In particular, the fundamental concepts address the items that meet the definitions of elements of financial statements; how those items should be recognized, measured, and disclosed; and how they should be summarized and presented in financial statements.

### Measurement

S2. This chapter sets forth concepts on how items recognized in financial statements should be measured and provides guidance on when a specific measurement system should be applied.

S3. Measurement is anchored in prices—both entry prices and exit prices. Prices objectively measure the financial effects of transactions and other events and circumstances on the reporting entity and, consequently, are fundamental in depicting recognized items in general purpose financial reporting.

S4. This chapter describes two relevant and representationally faithful measurement systems: the entry price system and the exit price system. The prices in those measurement systems are defined as follows:

a. Entry price: The price paid (the value of what was given up) to acquire an asset or received to assume a liability in an exchange transaction
b. Exit price: The price received (the value of what was received) to sell an asset or paid to transfer or settle a liability in an exchange transaction.

S5. The conceptual premise in any measurement system is that the reported amounts of assets should not be more than what is recoverable, by disposition or use, and the reported amount of liabilities should not be less than what is settleable, by transfer or satisfaction. A measurement amount that does not meet the recoverability or settleability premise provides less predictive or confirmatory value and, consequently, yields less relevant financial information.

S6. Choosing between the entry price system and the exit price system should be guided by whichever system best meets the objective of general purpose financial reporting for a particular asset or liability being measured. Determining which measurement system is more relevant depends on the asset or liability itself and how that asset or liability is used or settled.

## Questions for Respondents

S7. The Board invites individuals and organizations to comment on all matters in this Exposure Draft, particularly on the questions below. Comments are requested from those who agree with the proposed concepts as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed concepts are asked to describe their suggested alternatives, supported by specific reasoning.

**Question 1:** Do you agree with the proposed underlying premise that to have predictive value the reported amounts of assets should not be more than what is recoverable, by disposition or use, and the reported amounts of liabilities should not be less than what is settleable, by transfer or satisfaction? Please explain why or why not.

**Question 2:** Do you agree that measurement is anchored in prices, as described in paragraphs M5 and M6? Do you also agree that transactions and other events and circumstances affecting the entity should ultimately be measured in prices (entry prices and exit prices)? Please explain why or why not.

**Question 3:** Do you agree with the proposed description and features of the entry price system as described in paragraphs M10–M14? Please explain why or why not.

**Question 4:** Do you agree with the proposed description and features of the exit price system as described in paragraphs M15–M19? Please explain why or why not.

**Question 5:** Do you agree that the entry price and exit price systems, as explained in paragraph M7, are the only two relevant and representationally faithful measurement systems that would meet the objective of general purpose financial reporting? Please explain why or why not.

**Question 6:** Do you agree that the entry price system would likely result in more relevant measurements when entities have unique exit prices for the same asset or liability? Please explain why or why not. (See paragraph M31.)

**Question 7:** Do you agree that the exit price system (specifically, an exit price that incorporates market participant cash flows) would likely result in more relevant measurements when entities have the same exit price for the same asset or liability? Please explain why or why not. (See paragraph M32.)

# Conceptual Framework for Financial Reporting

## CHAPTER 6: MEASUREMENT

## Introduction

M1. The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity.[1] Investors', lenders', and other creditors' expectations about returns depend on their assessment of the amount, timing, and uncertainty of (the prospects for) future net cash inflows to the entity. To assess an entity's prospects for future net cash inflows, existing and potential investors, lenders, and other creditors need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Accrual basis earnings are useful in assessing the effectiveness and efficiency of management.

M2. The qualitative characteristics of useful financial information describe the characteristics of financial information needed to best meet that objective.[2] Useful financial information must possess two fundamental qualitative characteristics—relevance and faithful representation. To be relevant, financial information must be capable of making a difference in the decisions made by users. Financial information is capable of making a difference in users' decisions if it has predictive value, confirmatory value, or both. To be a faithful representation, financial information must be complete, neutral, and free from error to the greatest extent possible.

M3. Other aspects of the Conceptual Framework, including measurement, flow logically from the objective. This chapter discusses measurement in financial

[1]The objective is described and explained in paragraphs OB2–OB4 of Chapter 1, *The Objective of General Purpose Financial Reporting,* of this Concepts Statement.

[2]The fundamental qualitative characteristics of useful financial information are described and explained in paragraphs QC5–QC18 of Chapter 3, *Qualitative Characteristics of Useful Financial Information*, of this Concepts Statement.

statements, which is the process of determining relevant numerical depictions of items recognized in financial statements, which result in faithful representation.

## Measurement

M4. Measurement is the process of determining relevant numerical depictions of items recognized[3] in financial statements. The conceptual premise in any measurement system is that the reported amounts of assets should not be more than what is recoverable, by disposition or use, and the reported amounts of liabilities should not be less than what is settleable, by transfer or satisfaction. A measurement amount that does not meet the recoverability or settleability premise provides less predictive or confirmatory value and, consequently, yields less relevant financial information. The measurement process results in assigning a value to a recognized item in financial statements. Consideration of measurement occurs at (a) the initial recognition of an asset or a liability[4] and (b) each subsequent reporting date. The measurement amount at a subsequent reporting date may be the initial measurement amount, or that initial measurement amount may be remeasured or adjusted. Both the initial measurement or any change to the initial measurement amount may result in the recognition of revenue, expense, gain or loss, or investment by or distribution to owners; therefore, measurement may have consequences on the statement of financial position and the statement of comprehensive income.

M5. Measurement is anchored in prices—both entry prices and exit prices. Both business entities and not-for-profit entities engage in activities with other parties to acquire and provide goods and services and transact with providers of financial capital. Those activities and transactions often have observable entry and exit prices because an exchange has occurred at a known or contracted amount. When an exchange occurs, that price is an entry price to one party and an exit price to the counterparty. Prices objectively measure the financial effects of transactions and other events and circumstances on the reporting entity and, consequently, are fundamental in depicting recognized items in general purpose financial reporting. An agreed-upon price often is considered to be an exchange at fair value absent evidence to the contrary. Circumstances in which there may be evidence to the contrary are discussed in paragraphs M23–M27.

[3]The recognition criteria for an item and its financial information to be recognized in financial statements are described and explained in paragraphs RD4–RD7 of Chapter 5, *Recognition and Derecognition*, of this Concepts Statement.

[4]Consideration of measurement also is necessary for equity instruments in certain equity transactions, as described in paragraph M26.

M6. In many exchange transactions, an entry price and an exit price are easily observed.[5] In the absence of an observable exchange transaction (see paragraphs M23–M27), when consideration in an exchange transaction depends on an uncertain outcome, or in nonmonetary transactions, prices are estimated[6] rather than observed. If a price for an asset or liability or a similar asset or liability can be observed in the marketplace, that price represents a basis for estimation. When the price of that or a similar asset or liability is not observable, estimates of future cash flows that are expected from transactions and other events and circumstances should be calculated with the objective of replicating prices. Estimating a price from cash flow estimates may be from a market participant perspective[7] or from an entity-specific perspective. Therefore, measurement is anchored in prices, even when the entity's price is not directly observable.

## Measurement Systems

M7. There are two relevant and representationally faithful measurement systems: the entry price system and the exit price system.[8] The prices in those measurement systems are defined as follows:

a. Entry price: The price paid (the value[9] of what was given up) to acquire an asset or received to assume a liability in an exchange transaction
b. Exit price: The price received (the value[10] of what was received) to sell an asset or paid to transfer or settle a liability in an exchange transaction.

M8. Both systems record entry prices when assets and liabilities are acquired. The entry price system requires costs to be accumulated and allocated over a benefit period or accrued over an obligation period subject to the recoverability and settleability premise described in paragraphs M4 and M12. The exit price system requires remeasurement at each reporting date. Both systems record exit prices

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[5]Certain transactions in which there may be multiple elements bundled together, such as a revenue contract or a business combination, may have an entry price or an exit price that is easily observed for the total transaction but not for the separate elements of the transaction.

[6]If the risks of performance are inherent in an entity's cash flow estimate, the entity should discount the estimate using the risk-free rate. Otherwise, the effect of some assumptions will be double-counted.

[7]Cash flow estimates from a market participant perspective also are referred to as *fair value*.

[8]When a price is used as a measurement, there are consequences that affect subsequent measurement and allocation decisions. This chapter refers to the initial measurement at a price and the corresponding consequences of that choice as a measurement system.

[9]Value refers to the amount of the cash or equivalent value of the asset given up or received, or the liability incurred or settled, in an exchange transaction.

[10]See footnote 9.

at the point that assets are sold or liabilities are transferred or settled. The choice between the systems is for the measurement at each reporting date.

M9. The conclusion of this chapter is that more than one measurement system is necessary to meet the objective of general purpose financial reporting. The acceptance of multiple measurement systems is predicated on the assumption that the selection between alternative measurement systems will be based on which measurement system best meets the objective of general purpose financial reporting and best possesses the qualitative characteristics of decision-useful information for the asset or liability being measured. In addition, selection between alternative measurement systems will be subject to the cost constraint as described in paragraph M47.

## Entry Price System

M10. To provide useful financial information, the entry price measurement system[11] requires that the asset acquired be initially recorded at entry price (cost) and that the cost be allocated over its benefit period, resulting in an adjusted entry price. Similarly, the costs associated with the incurrence of a liability are allocated to each reporting period until the liability is settled. The allocation of costs to an expected benefit period should be done in a systematic manner, often through amortization or accretion.

M11. Systematic amortization or accretion of an asset or liability is not intended to approximate an entry price or an exit price. Rather, systematic amortization and accretion are adjustments intended to allocate a portion of the entry price to revenue or an expense each reporting period. Systematic amortization or accretion may be the result of a contractual arrangement, such as interest accretion on a loan, or the result of arithmetically allocating the carrying value of a recognized item over its expected benefit period, such as depreciation. Decisions about specific allocation requirements should be determined at the standards level.

M12. The entry price system assumes that the reported amounts of assets should not be more than what is recoverable, by disposition or use, and the reported amount of liabilities should not be less than what is settleable, by transfer or satisfaction over an expected benefit period. This premise may not be met by applying a cost allocation process. As a result, there are circumstances that require an entity to consider whether the adjusted entry price of an asset or a liability should be remeasured. The adjusted entry price of an asset or a liability is remeasured to reflect the impairment of the asset's value or the modification of the liability's settlement value. In those circumstances, the new measurement

[11]The entry price measurement system often is referred to as the *historical cost system*.

assigned to the asset or liability should be an exit price to meet the recoverability and settleability conceptual premise.

M13. In the acquisition of some assets, certain actions must be taken to get the asset to the location and condition necessary to function as intended. Prices related to those actions—such as taxes and shipping and handling costs—should be included within the initial entry price of an asset to be consistent with the premise of the entry price system. Although each of those costs may not meet the definition of an asset individually, each would be allocated over the underlying asset's expected benefit period to be consistent with the premise of the entry price system. Decisions about which actions are necessary and thus have a related price that would be included within the initial entry price should be determined at the standards level.

M14. Similarly, transaction costs, such as legal and underwriting costs, that are necessary to incur an obligation should be netted against the proceeds to adjust the entry price of the liability to be consistent with the entry price measurement system's premise of allocating costs over their benefit period. These items are not assets but are expenses. Under the entry price measurement system, those costs should be allocated over the periods that the liability is outstanding by accreting the liability to the contracted or estimated settlement amount. Decisions about which costs are necessary to incur an obligation should be determined at the standards level.

## Exit Price System

M15. To provide useful financial information, the exit price measurement system requires that an asset or a liability be recorded at the market participant value or entity-specific value that an entity would receive from selling an asset or would pay to transfer or settle a liability. In the exit price measurement system, assets and liabilities at the first reporting date after acquisition are measured at the estimated exit price and remeasured at each reporting date to reflect the estimated exit price at that reporting date. Any difference between the estimated exit price at the first reporting date and the transacted entry price, as well as the impact of any remeasurements in subsequent reporting dates, should be reported in comprehensive income.

M16. An exit price is not observable until a transaction occurs. In some circumstances, exit prices may be determinable by a contracted amount. If exit prices cannot be determined, they should be estimated, whether from a market participant perspective or from an entity-specific perspective. Exit prices of assets and liabilities at fair value can be readily estimated when an active market exists for identical assets and liabilities. For other assets and liabilities, exit prices at fair value must be estimated by (a) comparing them with similar assets or liabilities or (b) calculating an exit price from assumptions that market participants would make. Entity-specific exit prices must be estimated by calculating an exit price from assumptions that an entity itself would make. As such, all fair values estimate an exit price, but all exit prices are not necessarily measured at fair value.

M17. In the exit price system, the costs to acquire an asset or assume a liability, as described in paragraphs M13 and M14 (excluding the cost of the asset or liability), should be expensed as incurred unless the counterparty in a transaction would be willing to include those costs incurred in its entry price if the asset was acquired or the liability was assumed.

M18. Unlike the entry price measurement system, the exit price measurement system does not allocate costs to each reporting period. A change in the exit price from the beginning of the reporting period to the end of the reporting period should be reported in comprehensive income. Consequently, the exit price measurement system does not necessitate considering either impaired assets or onerous liabilities because the conceptual premise that the reported amounts of assets and liabilities will be recovered or settled, respectively, should be met at each reporting date under the exit price system.

M19. The exit price of a liability may not equal the contractual amount that the counterparty requires to settle the liability. For example, a change in interest rates over the contract period of a liability may change the fair value of that liability to an amount different from the amount required to settle that liability with the counterparty. Similarly, some assets may require significant disposition expenses; consequently, the ultimate proceeds realized from the sale of an asset will not be the same as the exit price of that asset.

## Cash Flows as an Estimate of Entry and Exit Prices

M20. Cash flow estimates can be made from a market participant perspective (which would estimate fair value) or from an entity-specific perspective. Cash flow estimates must consider the amount, timing, and uncertainty of the future cash flows expected from transactions and other events and circumstances. Consideration of the amount, timing, and uncertainty of the estimated cash flows determines the value of those cash flows. Therefore, there is no conceptual justification for not considering the time value of money in a cash flow estimate of a price.

M21. The objective of estimating entry prices with cash flows is to determine the value of what was given up to acquire an asset or received to assume a liability. The objective of estimating exit prices with cash flows is to determine the price that would be received from selling an asset or that would be paid to transfer or settle a liability. If an estimation is made from a market participant perspective, the price should be calculated using assumptions that a market participant would make. If an estimation is made from an entity-specific perspective, the measurement process would consider unique advantages or disadvantages of the entity to determine the value of the cash flows. Both estimations would represent prices to the entity, but the value of the cash flows may not be the same, and only the estimates from the market participant perspective would represent fair value.

M22. Exit price measurements based on estimated cash flows raise issues for subsequent measurement when the amount, timing, or uncertainty of the expected cash flows changes. Each of those changes would cause a change in the value of the expected cash flows and should result in considering remeasurement from either a market participant perspective or an entity-specific perspective. Changes in interest rates also modify the value of the cash flows and should result in considering remeasurement from either a market participant perspective or an entity-specific perspective. However, the original discount rate assumption may be retained in an exit price from an entity-specific perspective if that discount rate would better incorporate the unique advantages or disadvantages of the entity.

## Specific Measurement Circumstances

M23. Entry and exit prices are considered to be exchanges at fair value, absent evidence to the contrary. That conclusion rests on the presumption that transactions have been consummated on an arm’s-length basis between independent parties. As such, circumstances in which there is evidence that the exchange was not at fair value or circumstances in which the fair value of the transaction involving multiple items is only available for the transaction as a whole necessitate special consideration.

M24. Transactions between related parties occur at amounts that are not determined by a price that resulted from negotiations between independent unrelated parties. The price specified in the arrangement is used to record that arrangement with disclosures required to alert financial statement readers of the nature of the arrangements. Consequently, the stipulated value cannot be assumed to be an amount that would represent an exchange at fair value. Resolution of the complexities of accounting for related party transactions should be determined at the standards level.

M25. Charitable contributions are transactions in which the recipient of a contribution did not actively participate in establishing the amount to be received as a basis for the transaction. Contributions are typically measured at the fair value of what was contributed by the donor. Resource providers for both parties to this nonreciprocal transaction are interested in the fair value of what was exchanged. Exceptions to this practice should be determined at the standards level.

M26. Ownership interests often are exchanged between owners of equity interests in transactions that do not involve participation by the issuing entity. These market-based transactions typically result in establishing values of ownership interests absent the participation of the issuing entity. Issuance or acquisition of equity interests by the issuing entity at a price other than the value established in the independent market suggests that the arrangement may have created rights and obligations that should be identified and considered for recognition.

M27. Some transactions, such as a purchase of a group of assets or liabilities, require allocating the entry price value to distinct assets acquired and liabilities assumed. The entry price should be allocated at the relative fair values of what was acquired if that is the best approximation of an entry price of the individual assets or liabilities. Exceptions to that practice should be determined at the standards level.

## Choosing between the Relevant Measurement Systems

M28. Choosing between the entry price system and the exit price system should be guided by whichever system best meets the objective of general purpose financial reporting for a particular asset or liability being measured. Chapter 3 of this Concepts Statement identifies and describes the qualitative characteristics that financial information should have if it is to meet the objective of financial reporting. Information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant measure nor an unfaithful representation of a relevant measure helps resource providers make informed decisions.

### Relevance

M29. Information is relevant if it is capable of making a difference in the decisions made by resource providers. Information is capable of making a difference in decisions if it has predictive value or confirmatory value (or both). These decisions include buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. These decisions depend on the returns that existing and potential investors or lenders expect from their investments. Expectations about returns often depend on an assessment of the amount, timing, and uncertainty of the prospects for future net cash inflows to the entity. Whichever measurement system best helps resource providers assess the amount, timing, and uncertainty of future net cash flows to the entity will be more relevant.

M30. Determining which measurement system is more relevant depends on the asset or liability itself and how that asset or liability is used or settled. How assets and liabilities are used should be considered when making measurement decisions at the standards level. In some circumstances, two entities could realize a different price if provided with the same asset (for example, inventory) and could settle the same liability (for example, warranty accrual) with a different price. In contrast, in other circumstances, other market participants could realize the same price if provided with the same asset (for example, investment in an equity security) and could settle the same liability (for example, a cash-settled derivative) with the same price. Whether an asset or a liability is used in combination with other assets and liabilities or is used on a standalone basis may be an indicator of whether two different entities could realize a different price for that same asset or liability. Assets or liabilities used in combination with other assets or liabilities are more likely to result in a unique price, while assets or liabilities used on a standalone basis are more likely to result in a nonunique price.

M31. The entry price system would likely result in more relevant measurements when entities have unique exit prices for the same asset or liability. That is because for assets and liabilities with unique exit prices, the entry price system better maintains the historical relationship between revenues and the costs incurred and the assets employed to generate those revenues. These historical relationships are an important starting point in the process of predicting future unique net cash flows. Information about the return that the entity has produced from its entry price provides an indication of how well management has discharged its responsibilities to make efficient and effective use of the reporting entity's resources. The exit price system (specifically, an exit price that incorporates market participant cash flows) (a) does not maintain those historical relationships and (b) reflects nonunique prices that are different from and, therefore, may not necessarily be confirmatory or predictive of the unique cash flows.

M32. However, the exit price system (specifically, an exit price that incorporates market participant cash flows) would likely result in more relevant measurements when entities have the same exit price for the same asset or liability. That is because the prices associated with the asset or liability are often more exposed to fluctuations in market conditions. Exit prices that incorporate market participant cash flows provide more useful information to users because these prices help users better understand the risks and uncertainties inherent in those potential cash flows. Because an estimated exit price is intended to represent the amount of an exchange transaction, this information is predictive of the market participant cash flows and can be used to confirm or revise earlier expectations. The exit price system (specifically, an exit price that incorporates market participant cash flows) also allows for assessment of how well management has discharged its responsibilities to make efficient and effective use of the reporting entity's resources related to opportunities not pursued. When assessing the solvency and liquidity of an entity, exit prices from a market participant perspective are particularly useful (for example, for use in determining collateral that may be available to help provide funding).

M33. Measurement uncertainty also should be considered when analyzing the relevance of the measurement systems. If the level of uncertainty in an estimate under one of the measurement systems is of concern, that estimate may not be particularly useful, and the other measurement system should be considered. However, if only one measurement system would result in decision-useful information for a particular asset or liability, that measurement system may still provide relevant information even if highly uncertain.

## *Price and Cash Flows*

M34. Transactions associated with different activities may have significantly different prices, and those activities may help indicate whether an entity could receive a unique price or a nonunique price for the transaction. Most entities engage in more than one activity. For example, an entity may produce or purchase goods and services, sell goods and services, and invest in assets not currently employed in producing goods and services. Those different activities may have significantly different effects on profitability and cash flows.

M35. Commercial activity of both business entities and not-for-profit entities involves buying goods or services necessary to produce the goods or services they provide to generate cash flows. The net cash flows from those transactions often are recurring and helpful in predicting future cash flows to an entity. Distinction between assets that directly provide cash flows and assets that only provide cash flows when used with other assets or resources may be an indicator when choosing between measurement systems.

M36. The type of activity does not necessarily indicate conclusively whether an entity could receive a unique price or a nonunique price. For example, the same activity of a sale could result in receiving a unique price for the asset (for example, inventory) or could result in receiving a nonunique price for the asset (for example, a commodity). Two different retailers could sell the same inventory for a different price, indicating that distinguishing characteristics of each entity could affect the price that could be realized from the sale. On the other hand, such characteristics would have no impact on the price of gold as a commodity.

M37. The entry price system retains the historical cost structure for items like inventory. Resource providers would be able to evaluate the relationship of the cost structure with current and future earnings. The exit price system (specifically, an exit price that incorporates market participant cash flows) depicts the sensitivity of changing economic conditions for items like commodities. Correspondingly, resource providers may better understand the risks and uncertainties inherent in these potential cash flows. Furthermore, an exit price that incorporates market participant cash flows may offer more predictive value because it would represent the price that would be expected to be received for the commodity.

M38. As with assets, the type of activity for a liability does not necessarily indicate conclusively whether an entity could settle or transfer the liability at a unique or nonunique price. For example, the same activity—performance according to terms of an arrangement—could result in settling at a unique price (for example, warranties) or could result in settling at a nonunique price (for example, a trading-account liability). Distinguishing characteristics of each entity could affect the price at which the entity settles or transfers its warranties, while such characteristics would have no impact on the settlement price of a trading-account liability.

M39. The entry price system would better retain the historical cost structure for items like warranties. Resource providers would be able to evaluate the relationship of the cost structure with current and future earnings. The exit price system (specifically, an exit price that incorporates market participant cash flows) may better depict the sensitivity of changing economic conditions, allowing resource providers to better understand the risks and uncertainties inherent in these potential cash flows for items like trading-account liabilities. Furthermore, an exit price that incorporates market participant cash flows may offer more predictive value because it would align with the price that may be expected to be paid to settle the trading-account liability.

## Faithful Representation

M40. To be useful, financial information must represent relevant phenomena and must faithfully represent the phenomena that it purports to represent. A perfectly faithful representation is complete, neutral, and free from error. In this context, free from error does not mean perfectly accurate in all respects. For example, an estimate of an unobservable price cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate. Application of either the entry price or the exit price measurement system provides measurements that can be faithfully represented.

## Enhancing Qualitative Characteristics

M41. Comparability, verifiability, timeliness, and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics also may help determine which of the two measurement systems should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

M42. Enhancing qualitative characteristics should be maximized to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or not faithfully represented. Applying the enhancing qualitative characteristics is an iterative process that does not follow a prescribed order. Sometimes one enhancing qualitative characteristic may have to be diminished to maximize another qualitative characteristic.

### Comparability

M43. Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences between, items. Likewise, using the same measurement system from period to period can help make financial statements more consistent, which is an aspect of comparability. Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different.

### Verifiability

M44. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Using a measurement system that can be independently corroborated, for example, by observable prices or inputs, will enhance verifiability.

### Timeliness

M45. Timeliness means having information available to decision makers in time to be capable of influencing their decisions. Generally, the older the information is, the less useful it is. However, some information may continue to be timely long after the end of the reporting period because, for example, resource providers use financial information to identify and assess trends.

## Understandability

M46. Classifying, characterizing, and presenting information clearly and concisely makes it understandable. Using multiple measurement systems for unique prices and using multiple measurement systems for nonunique prices may decrease understandability.

## Cost Constraint

M47. Cost is a pervasive constraint on the information that can be provided by financial reporting. Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information. Paragraphs QC35–QC39 of Chapter 3 discuss several types of costs and benefits to consider. Dependent on these considerations and the item being measured, the benefits of one measurement system may not justify the costs.

*This proposed Concepts Statement was approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:*

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph

# Appendix A: Basis for Conclusions

## Introduction

BC6.1. The following basis for conclusions summarizes the Board's considerations in reaching the conclusions in this chapter. It includes reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than others.

BC6.2. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, was originally issued in 1984. That Concepts Statement addressed recognition, measurement, and certain concepts for presentation. With regard to measurement, Concepts Statement 5 was criticized as being a description of practice rather than providing a conceptual basis for standard-setting decisions. The Board concluded that the discussion of measurement should be further developed with the objective of providing a framework for analyzing measurement issues more consistently.

BC6.3. The Board began the process of developing measurement concepts by reviewing its existing Concepts Statements as well as the frameworks of other standard setters. The Board then reviewed and considered various publications of the International Accounting Standards Board (IASB) and the work of researchers associated with other standards boards. The Board also considered the partial results of the work done on measurement before the Board and the IASB discontinued their joint project on the Conceptual Framework.

BC6.4. This chapter describes:

a. Two relevant and representationally faithful measurement systems: the entry price system and the exit price system
b. Considerations necessary to choose between those measurement systems.

BC6.5. In the Board's view, this chapter provides sufficient guidance for the Board to consider in developing measurement requirements at the standards level. Concepts Statement 5 stated that items reported in financial statements are measured by different measurement attributes. This chapter replaces that discussion with a framework in which items recognized in financial statements should be measured by measurement systems. This chapter does not conclude which measurement system should be used for any particular asset or liability.

## Measurement Concepts and the Objective of Financial Reporting

BC6.6. This chapter provides concepts for the Board to consider when choosing a measurement system for an asset or a liability recognized in general purpose financial statements. This choice is necessary to carry out the objective of general purpose financial reporting as described in Chapter 1.

BC6.7. In developing this chapter, the Board considered whether one single measurement system could meet the objective of financial reporting. A majority of the Board identified the following potential advantages of using a single measurement system:

a. The amounts recorded in financial statements could be easily compared across entities.
b. The financial statements would be less complex and more understandable.

BC6.8. However, the Board ultimately concluded that multiple measurement systems are necessary to meet the objective of financial reporting. The Board reasoned that consideration of the objective of financial reporting, the qualitative characteristics of useful information, and the cost constraint are likely to result in selection of different measurement systems for different types of assets and liabilities. Financial reporting serves a variety of resource providers and other users of financial information whose various needs also led the Board to conclude that more than one measurement system is necessary to meet the objective of general purpose financial reporting.

BC6.9. Both the entry price system and the exit price system are subject to the assumption in paragraph M4 that reported amounts of assets and liabilities should not be more than what is recoverable, by disposition or use, or less than what is settleable, by transfer or satisfaction. The Board concluded that a failure to meet this premise would result in measurements with less predictive and confirmatory value.

BC6.10. Commercial activity is largely carried out through exchange transactions of goods and services. The prices in these exchange transactions are typically easily observed and represent an objective measure of the initial recognition of an asset or liability. In circumstances in which the exchange price of the asset or liability cannot be observed, the Board concluded that the objective of the measurement should still be to consistently measure assets and liabilities at amounts that estimate prices.

BC6.11. The objective of both systems is to provide information useful to resource providers about the factors described in paragraph M1. The Board concluded that both systems provide that information and that selection between the two systems should be based on the asset or liability itself and how that asset or liability is used or settled. Fundamental to meeting that assumption is an expectation of future cash flows to the entity. Resource providers often make resource allocation decisions on the basis of an expectation of future cash flows to the entity; therefore, information that is useful would help a resource provider make that assessment.

BC6.12. The Board observed that measurement, presentation, and disclosure all work together to achieve the objective of financial reporting. Predicting future cash flows to the entity and, consequently, earnings of the entity, is enhanced by presenting line items in comprehensive income consistent with the objectives of presentation concepts in Chapter 7, *Presentation*.

BC6.13. The Board has evaluated various approaches to measurement throughout the development of this chapter. First, the Board considered basing measurement on the characteristics of assets and liabilities alone. Next, the Board considered basing measurement on how an asset or liability is used or settled alone. Neither of those approaches was successful in developing a framework to select a measurement system that best meets the objective of financial reporting. Because of the variety of assets and liabilities and different ways that assets and liabilities are capable of being used or settled, an approach that focuses only on one of those factors is insufficient in selecting between alternative measures.

BC6.14. As such, the Board concluded that selection between measurement systems should be based on both the asset or liability that is being measured and how it is used or settled. Combining the two previous approaches results in evaluating whether other market participants would realize the same price if provided with the same asset or settle the same liability at the same price. The Board concluded that basing measurement on the distinction between unique prices and nonunique prices would best meet the objective of financial reporting, as discussed in paragraphs M30–M32.

BC6.15. As discussed in paragraph M21, estimates of an exit price can be from either a market participant perspective or an entity-specific perspective. Paragraphs M28–M33 describe considerations when choosing between the entry price system and the exit price system for an asset or a liability. Paragraphs M34–M39 provide examples of items that may be recognized under each system to aid the Board in its understanding of the measurement system's applicability. The description and examples provided for the exit price system primarily reflect scenarios that use exit prices from a market participant perspective. The Board decided that both market participant and entity-specific perspectives are crucial to the exit price system. However, the Board determined that a stronger distinction between the entry price system and the exit price system can be made through the utilization of examples of exit prices from a market participant perspective.

BC6.16. The Board considered whether portions of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* should be retained as an appendix to this chapter. Concepts Statement 7, which was issued in 2000, addressed the use of probability-weighted cash flows to estimate market participant exit prices (fair value). The Board observed that the standard-setting environment, as well as practice, has evolved since the issuance of Concepts Statement 7. Therefore, the Board decided to supersede Concepts Statement 7 in its entirety. The Board noted that Concepts Statement 7 relates to a small aspect of this chapter and it is more illustrative rather than conceptual in nature.

# Appendix B: Amendments to the *Conceptual Framework for Financial Reporting*

## Replacement of Concepts Statement 5

B1. Chapter 6 of Concepts Statement 8 replaces Concepts Statement 5.

## Replacement of Concepts Statement 7

B2. Chapter 6 of Concepts Statement 8 replaces Concepts Statement 7.

## Amendments to Concepts Statement 8

B3. Chapter 5, *Recognition and Derecognition*, and Chapter 7 of Concepts Statement 8 are amended as described in paragraphs B4–B6. Added text is underlined, and deleted text is ~~struck out~~.

### Amendments to Chapter 5 of Concepts Statement 8

B4. Amend paragraph RD5(b) as follows:

> RD5. An item and its financial information should meet three recognition criteria to be recognized in financial statements, subject to the pervasive cost constraint and materiality considerations. Those criteria are:
>
> b. *Measurability*—The item is measurable ~~and has~~with a relevant measurement ~~attribute~~system.

B5. Amend paragraph RD9 as follows:

> RD9. An item must be measurable with a relevant measurement ~~attribute~~system to be recognized in financial statements. A relevant measurement ~~attribute~~system for an item being considered for recognition cannot be determined in isolation. Relevance should be evaluated in the context of the objective of general purpose financial reporting: providing financial information about a reporting entity that is useful to existing and potential investors, lenders, and other resource providers in making decisions about providing resources to the entity.

## Amendment to Chapter 7 of Concepts Statement 8

B6. Amend footnote 4 of paragraph PR12 as follows:

> [4]*Recognition criteria* are in Chapter 5, *Recognition and Derecognition*, of this Concepts Statement<u>, while measurement concepts are in Chapter 6, *Measurement*, of this Concepts Statement</u>.