



# Exposure Draft

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June 3, 2013

Comments Due: September 30, 2013

Proposed Statement  
of the Governmental Accounting Standards Board  
on concepts related to

## Measurement of Elements of Financial Statements

This Exposure Draft of a proposed Statement of Governmental Accounting Concepts is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities  
Project No. 3-20E

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Governmental Accounting Standards Board

# MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS

## Notice of Public Hearing and Request for Written Comments

**Public Hearing.** A public hearing is scheduled on November 1, 2013, beginning at 8:30 a.m. at the Sheraton LaGuardia East Hotel, 135-20 39<sup>th</sup> Ave., Flushing, NY. The hearing is being held in combination with the public hearing on the Preliminary Views on major issues related to *Fair Value Measurement and Application* (the Fair Value Preliminary Views). Interested individuals or organizations may participate in the public hearing in person or by telephone.

**Deadline for written notice of intent to participate in the public hearing:**

**September 30, 2013**

## PUBLIC HEARING

**Basis for the public hearing.** The GASB has scheduled the public hearing to obtain information from interested individuals and organizations about the issues discussed in this Exposure Draft and in the Fair Value Preliminary Views. The hearing will be conducted by one or more members of the Board and its staff. Interested parties are encouraged to participate at the hearing and through written response.

**Public hearing oral presentation requirements.** Individuals or organizations that want to make an oral presentation in person or by telephone at the public hearing are required to provide, **by the deadline for notice of intent to participate (September 30, 2013)**, a written notification of that intent and a copy of written comments addressing the issues discussed in this Exposure Draft. The notification and written submission should be addressed to the Director of Research and Technical Activities, Project No. 3-20E, and emailed to [director@gasb.org](mailto:director@gasb.org) or mailed to the address below. The notification should indicate a preference for participating in person or via telephone. The public hearing may be canceled if sufficient interest is not expressed by the deadline.

The Board intends to schedule all respondents who want to make oral presentations and will notify each individual or organization of the expected time of the presentation. The presentation may address issues discussed in this Exposure Draft, the Fair Value Preliminary Views, or both documents. The time allotted each individual or organization will be limited to about 30 minutes—10 minutes to summarize or elaborate on the written submission, or to comment on the written submissions or presentations of others, and 20 minutes to respond to questions from those conducting the hearing.

**Observers.** Observers are welcome at the public hearing and are urged to submit written comments.

## WRITTEN COMMENTS

**Deadline for submitting written comments: September 30, 2013**

**Requirements for written comments.** Any individual or organization that wants to provide written comments but does not intend to participate in the public hearing should provide those comments **by September 30, 2013**. Comments should be addressed to the Director of Research and Technical Activities, Project No. 3-20E, and emailed to [director@gasb.org](mailto:director@gasb.org) or mailed to the address below.

## OTHER INFORMATION

**Public Files.** Written comments and transcripts of the public hearing will become part of the Board's public file and will be available for inspection at the Board's offices. Written comments also are posted on the GASB's website. Copies of the transcript may be obtained for a specified charge.

**Orders.** This Exposure Draft may be downloaded from the GASB's website at [www.gasb.org](http://www.gasb.org). Any individual or organization may obtain one printed copy of this Exposure Draft on request without charge until September 30, 2013, by writing or phoning the GASB Order Department. For information on prices for additional copies and copies requested after that date, please contact the Order Department at the following address:

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## **Notice to Recipients of This Exposure Draft**

The Governmental Accounting Standards Board develops Statements of Governmental Accounting Concepts primarily to guide its deliberations and decision making. The due process procedures that we follow before issuing our Concepts Statements are designed to encourage broad public participation. As part of that due process, we are issuing this Exposure Draft setting forth a proposed Concepts Statement on measurement of elements of financial statements.

We invite your comments on the matters in this proposed Concepts Statement. Because this proposed Concepts Statement may be modified before it is issued as a final Concepts Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of your comments, it would be helpful if you explain the reasons for your views, including alternatives that you believe we should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Concepts Statement. When the Board is satisfied that all alternatives have adequately been considered, and modifications have been made as appropriate, a vote is taken on the Concepts Statement. A majority vote of the Board members is required for adoption.

## Summary

This proposed Concepts Statement is one of a series of Concepts Statements that the GASB has issued or will issue. These Concepts Statements are intended to provide a conceptual framework of interrelated objectives and fundamental concepts that can be used as a basis for establishing consistent financial reporting standards.

Concepts Statements identify the objectives and fundamental principles of financial reporting that can be applied to solve numerous financial accounting and reporting issues. They provide the GASB with the basic conceptual foundation for considering the merits of alternative approaches to financial reporting and help the GASB develop well-reasoned financial reporting standards. These Concepts Statements also assist preparers, auditors, and users in better understanding the fundamental concepts underlying financial reporting standards. Concepts Statements do not prescribe the financial reporting standards that apply to a particular item or event.

This proposed Concepts Statement would establish concepts for measurement of elements of financial statements. The proposed Concepts Statement addresses both measurement approaches and measurement attributes. A measurement approach determines whether an asset or liability presented in a financial statement should be (1) reported at an amount that reflects a value at the date that the asset was acquired or the liability was incurred or (2) remeasured and reported at an amount that reflects a value at the date of the financial statements. A measurement attribute is the feature or characteristic of the asset or liability that is measured.

This proposed Concepts Statement establishes the two measurement approaches that would be used in financial statements, as follows:

- ***Initial-Transaction-Date-Based Measurement (Initial Amount)***—The transaction price or amount assigned when an asset was acquired or a liability was incurred, including subsequent modifications to that price or amount, such as through depreciation or impairment.
- ***Current-Financial-Statement-Date-Based Measurement (Remeasured Amount)***—The amount assigned when an asset or liability is remeasured as of the financial statement date.

This proposed Concepts Statement also establishes the four measurement attributes that would be used in financial statements, as follows:

- ***Historical cost*** is the price paid to acquire an asset or the amount received pursuant to the incurrence of a liability in an actual exchange transaction.
- ***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.
- ***Replacement cost*** is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.
- ***Settlement amount*** is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

## **How This Proposed Concepts Statement Would Improve Financial Reporting**

The proposed concepts, if ultimately issued as a Concepts Statement, would improve financial reporting by augmenting the framework through which the Board can enhance consistency in future standards setting. These proposed concepts address measurement that is a necessary component of a complete framework for reporting in traditional financial statements. These proposed concepts, when finalized, also may benefit preparers and auditors when evaluating transactions for which there are no existing standards or in implementing existing standards.

**Proposed Statement of the Governmental Accounting Standards Board  
on concepts related to**

**Measurement of Elements of Financial Statements**

**June 3, 2013**

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**Proposed Statement of the Governmental Accounting Standards Board  
on concepts related to**

**Measurement of Elements of Financial Statements**

**June 3, 2013**

**PURPOSE AND SCOPE**

1. Concepts Statements are intended to provide a framework of interrelated objectives and fundamental concepts that can be used as a basis for establishing consistent accounting and financial reporting standards. The conceptual framework provides the Board with the basic conceptual foundation for the development of accounting and financial reporting standards and for consideration of the merits of alternative approaches to accounting and financial reporting. Concepts Statements also assist preparers, auditors, and users of state and local government financial statements to better understand the fundamental concepts underlying accounting and financial reporting standards in the governmental environment. Concepts Statements are not used to prescribe the financial reporting standards that apply to a particular item or event.
2. Existing accounting pronouncements may be inconsistent with the concepts in this Concepts Statement. However, this Concepts Statement does not (a) require a change in existing generally accepted accounting principles for either accounting and financial reporting for specific transactions or for presentation of financial statements or (b) amend, modify, or interpret established accounting principles.
3. The objective of this Concepts Statement is to identify concepts for the Board to consider when developing standards for measurement of elements of financial statements. This Concepts Statement addresses both measurement approaches and measurement attributes. A measurement approach determines whether an asset or liability presented in a financial statement should be (a) reported at an amount that reflects a value at the date that the asset was acquired or the liability was incurred or (b) remeasured and reported at an amount that reflects a value of the asset or liability at the date of the financial statements. A measurement attribute is the feature or characteristic of the asset or liability that is measured.
4. The scope of this Concepts Statement is measurement of elements for traditional financial statements<sup>1</sup> of state and local governments. Other types of financial statements, measurement approaches, and measurement attributes may be appropriate for information presented in other types of general purpose external financial reporting.

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<sup>1</sup>In the context of this Concepts Statement, traditional financial statements are those that are prepared as of a certain date and for a period ended as of that date.

## MEASUREMENT APPROACHES IN FINANCIAL STATEMENTS

5. Measurement is the act or process of assigning dollar amounts to the elements presented in financial statements. Concepts Statement No. 4, *Elements of Financial Statements*, defines the elements of financial statements, which include assets, liabilities, deferred outflows of resources, deferred inflows of resources, net position, outflows of resources, and inflows of resources.

6. The measurement approach identifies the point in time to which the amount reported for an element of financial statements directly refers. There are two measurement approaches for elements of traditional financial statements.

- ***Initial-Transaction-Date-Based Measurement (Initial Amount)***—The transaction price or amount assigned when an asset was acquired or a liability was incurred, including subsequent modifications to that price or amount, such as through depreciation or impairment.
- ***Current-Financial-Statement-Date-Based Measurement (Remeasured Amount)***—The amount assigned when an asset or liability is remeasured as of the financial statement date.

7. In applying either measurement approach, various measurement attributes may be used. Measurement attributes are discussed in paragraphs 31–40.

### Focus on Assets and Liabilities

8. Measurement concepts focus on assets and liabilities because assessment of whether remeasurement is appropriate is directly relevant only for assets and liabilities. Evaluation of the measurement approach for deferred outflows of resources and deferred inflows of resources is not included in this Concepts Statement because measurement of deferred outflows of resources and deferred inflows of resources is determined from the measurement of the related asset or liability, either at the initial date of the transaction or at a subsequent reporting date. Evaluation of measurement approaches for outflows of resources and inflows of resources also is not included because outflows of resources and inflows of resources result from (a) the acquisition or consumption of assets, (b) the incurrence or satisfaction of liabilities, or (c) increases or decreases in existing assets or liabilities (or deferred outflows of resources or deferred inflows of resources). As such, measurement of outflows of resources and inflows of resources is determined through measurement of other elements. Evaluation of the measurement approach for the element of net position also is not included because net position is defined as the residual of the other elements in the statement of net position.

9. It is expected that one measurement approach will be applied to certain assets and liabilities and that the other measurement approach will be applied to other assets and liabilities. Applying a single measurement approach to all assets and liabilities would reduce the ability of financial statements to meet as many of the objectives of financial reporting described in Concepts Statement No. 1, *Objectives of Financial Reporting*, as

possible and would reduce the alternatives for achieving an appropriate balance among the qualitative characteristics of information.

## **Initial Amounts**

10. The initial amount at which an asset or a liability is reported may be determined in a variety of ways according to the nature of the asset or liability, with the goal of reporting it at an amount that reflects a value at the transaction date.

11. The amount at which an asset or liability is initially reported may be adjusted over time, and the resulting net amount still is considered to be an initial amount because it is derived from the amount at which the asset or liability was initially reported. Long-lived assets reported at initial amounts generally are associated with cost allocations to reporting periods. Balances of long-lived assets net of cost allocations are considered a form of initial amount.

12. Sometimes certain features of an asset or a liability make identification of an initial amount more difficult:

- Costs associated with some asset acquisitions, such as installation costs, generally are considered to be part of the initial amount of the asset.
- More than one asset or liability may be acquired or incurred in a single transaction, requiring the total transaction amount to be allocated to its components.
- The initial amounts of certain assets may include allocations that are inherently subjective in nature, such as overhead allocations to self-constructed assets.

These features present practical issues to be resolved in standards setting and do not present conceptual disadvantages to the use of initial amounts as the measurement approach.

## **Remeasured Amounts**

13. Remeasured amounts reflect the conditions in effect at the reporting date and may be determined using a number of methods. Remeasurement updates the amount reported for an asset or liability from an initial amount or previous remeasured amount to an amount indicative of a value at the end of the reporting period. Remeasured amounts establish a new carrying value for the asset or liability that is determined without reference to previously reported amounts.

## **Considerations for Evaluation of the Measurement Approaches**

14. This Statement builds upon the existing components of the GASB's conceptual framework. Concepts Statement 1, in particular, provides support for evaluating the measurement approaches. The overriding criterion in evaluating the measurement approaches is the degree to which the measurement approach promotes achievement of the applicable objectives of financial reporting, with consideration of the qualitative characteristics of information in financial reporting. For this purpose, the applicable

objectives of financial reporting are those that contain components that can be met through traditional financial statements. These objectives include providing information about:

- The relationship between current-year revenues and the cost of providing current-year services
- The sources and uses of financial resources
- How the governmental entity financed its activities and met its cash requirements
- The financial position and condition of a governmental entity to be used in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due
- A governmental entity's physical and other nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources.

15. Some objectives are met only through a statement of financial position, some only through a resource flows statement, and some through both. It is possible that application of one of the measurement approaches might promote an objective met through a statement of financial position, and application of the other measurement approach might promote a different objective met through a resource flows statement. However, only a single measurement approach should be applied to a specific asset or liability. If that measurement approach is to report a remeasured amount, then remeasurement gains or losses generally should be reported in the resource flows statement. Such remeasurement gains and losses generally cannot be reported as deferred outflows of resources and deferred inflows of resources because they relate to the current reporting period, not to future periods.

16. In addition, the qualitative characteristics of understandability, reliability, relevance, timeliness, and comparability should be considered when evaluating measurement approaches. The qualitative characteristic of consistency is not directly applicable to the evaluation of the measurement approaches. Rather, applying measurement approaches and measurement attributes in the same manner from period to period promotes consistency. In addition to the qualitative characteristics, the limitations identified by cost-benefit analyses should be considered.

## **Objectives of Financial Reporting, Qualitative Characteristics, and Cost-Benefit Limitations**

### **Relationship to the Objectives of Financial Reporting**

17. Financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided—an assessment of interperiod equity.<sup>2</sup> The cost of current-year services described in the objectives of

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<sup>2</sup>Interperiod equity is discussed in paragraphs 59–61 of Concepts Statement 1 and in paragraph 27 of Concepts Statement 4.

financial reporting traditionally has been viewed as a historical cost-based notion. When assets are acquired that will serve many periods, the cost of providing services with those assets during future periods should be a function of the historical cost paid (or other initial value) and their useful lives or service potential. Consequently, the use of initial amounts for assets used to provide services, such as capital assets and prepaid items, would be consistent with the objective of providing information about the cost of current-year services.

18. Initial amounts generally are not as useful as remeasured amounts in providing information to assess financial position, including the service potential of assets and the ability to meet obligations when due. A statement of financial position includes assets and liabilities acquired or incurred at varying points in time. Critical factors such as prices and interest rates change over time. Assets and liabilities measured using initial amounts will reflect the prices and interest rates at their respective transaction dates, not at the reporting date. Remeasured amounts, however, would provide better information about the remaining service potential of assets at the reporting date. For assets that will be used in providing services, a remeasured amount reflects an assessment of the value that the use of those assets will provide in the future. For assets that will be converted to cash, a remeasured amount better reflects the current value of the cash flows that the assets are expected to produce. Understanding of financial position is enhanced when liabilities are presented at a remeasured amount because a remeasured amount generally provides a better assessment of the magnitude of resources that are expected to be needed currently to satisfy the obligation. When remeasured amounts are used in the statement of financial position, those assets and liabilities have more meaning because they are presented on the same scale of measurement.

19. It may not be possible to report some assets or liabilities using a measurement approach that promotes the objectives of both (a) providing information about the cost of current-year services and (b) providing information about the financial position of a governmental entity to be used in assessing the level of services that can be provided by the governmental entity. Because only one measurement approach should be applied for a specific asset or liability, one objective will necessarily be given priority over the other. In these circumstances, the cost-of-services information has greater relevance in the governmental environment than the service-potential information because of the importance of providing information that can be used to assess interperiod equity.

20. Use of remeasured amounts is consistent with reporting gains and losses in a resource flows statement to demonstrate management's accountability. When management is being evaluated on its decisions as to whether to hold or sell assets or whether to settle liabilities early or in accordance with their stated terms, reporting of gains and losses based upon remeasurement of assets and liabilities provides better information for evaluating management's performance.

## **Qualitative Characteristics**

### ***Understandability***

21. The understandability characteristic recognizes that users of financial statements have varying levels of knowledge about financial reporting and that information should be presented as simply as possible. It does not, however, preclude presenting information only because it may be difficult to understand. Remeasurement of assets and liabilities and the reporting of unrealized gains and losses from remeasurement may be less understandable than use of initial amounts for some types of assets and liabilities, such as capital assets.

### ***Reliability***

22. The reliability of information about assets and liabilities reported using initial amounts generally is high. However, determining initial amounts may involve complexities that affect the faithful representation of initial amounts. The need to allocate the initial amounts of certain assets to periods may decrease reliability of the information because judgments may be needed to determine allocation periods. However, this concern can be addressed through communication methods other than recognition and display in financial statements, such as an explanatory disclosure in the notes to the financial statements.

23. Assessing reliability of remeasured amounts in some cases is complex. Reliability of remeasured amounts varies depending upon circumstances. Certain types of assets and liabilities can be remeasured reliably. These would include assets and liabilities for which there are active markets. An active market is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. With an active market, there is little doubt that the government could have sold the asset or satisfied the liability at the remeasured amount if it had so chosen at the reporting date. A stock exchange and the market for most U.S. Treasury securities are examples of active markets.

24. Some assets and liabilities can be remeasured with sufficient reliability because there is a valuation methodology that is widely accepted and reasonably free from bias. Many financial instruments, whether receivables or payables, would be classified in this category because their remeasured amounts can be determined by computing the present value of the expected cash flows. However, as uncertainty about the appropriate discount rate increases, such as might arise due to changes in the creditworthiness of the payer, the reliability of the measurement decreases. Some assets and liabilities are so unusual that the estimates used in determining remeasured amounts are uncertain to the extent that the resulting remeasured amounts would not be sufficiently reliable. In other circumstances, however, remeasured amounts are more reliable because remeasurement allows the effect of more recent events and changes in circumstances to be reflected in the estimates of the cash flows. A measurement that is biased would be inconsistent with the qualitative characteristic of reliability.

25. Some assets and liabilities do not trade in active markets, yet are traded in reasonably well-organized markets in which transactions involving similar assets or liabilities occur with some frequency. The markets for common types of vehicles or residential real estate are examples. These remeasured amounts would be sufficiently reliable when based on recent sales of similar items.

### ***Relevance***

26. Relevance requires the presence of many of the other qualitative characteristics. For example, if the information provided in a financial report is not timely or reliable, it may not be relevant. However, information can meet all other characteristics and still not be relevant. To be relevant, there should be a close logical relationship between the information provided and the purpose for which it is needed. The objectives of financial reporting identify the information that users of financial statements need for making decisions. Measurements are relevant when they promote the objectives of financial reporting.

### ***Timeliness***

27. Timeliness does not limit measurement to the use of initial amounts. The effect that using remeasured amounts has on the ability to provide timely information may vary depending on the extent of the measurement procedures and the availability of the information needed. Nevertheless, concerns regarding the potential effect of remeasurement on the timeliness of financial reporting generally can be addressed through sufficient planning.

### ***Comparability***

28. Information about governments is comparable when the information is presented using the same accounting principles. Thus, when governments report different information, it should be due to differences in their underlying transactions. Initial amounts provide greater comparability for cost-of-services information, which includes the cost of the use of capital assets in providing services. Use of initial amounts reflects differences in cost of services due to one government acquiring the capital assets used in providing services at a time when prices were more or less favorable than when the other government acquired its capital assets. Use of remeasured amounts would not result in reporting this difference in cost of services.

29. Remeasured amounts provide greater comparability than initial amounts for information reported in a statement of financial position, including information that can be used to assess the service potential of the resources reported. Remeasurement results in measurements of assets and liabilities as of the same point in time. By contrast, use of initial amounts results in measurements of assets and liabilities at the various respective dates when they were acquired or incurred. Comparability would be further enhanced through use of both the same measurement attribute and the same measurement method.

## Cost-Benefit Limitations

30. The cost of producing information should be considered in relation to the expected benefits provided by that information. Costs associated with continuing to report assets and liabilities at their initial amounts generally are minimal and do not limit the use of initial amounts. The cost of determining a remeasured amount is low when there are active markets for the asset or liability such that remeasurement can be made by reference to recent transaction prices. The cost of determining a remeasured amount may be higher for assets and liabilities that do not trade in active markets or for which the methodologies for remeasurement are complex and may require specific expertise. However, a significant cost for remeasurement does not automatically rule out the use of a remeasured amount. Failure to remeasure may lead to incomplete or misleading information being reported in financial statements. This is the case for liabilities associated with significant uncertainties, such as for certain pollution remediation obligations.

## MEASUREMENT ATTRIBUTES

31. Another dimension to measurement is the particular measurement attribute that is used, regardless of whether measurement is made as an initial amount or as a remeasured amount. A measurement attribute is a particular characteristic of an asset or liability that is being measured. There are four measurement attributes for elements of traditional financial statements: historical cost,<sup>3</sup> fair value, replacement cost, and settlement amount.

### Historical Cost

32. Historical cost is the price paid to acquire an asset or the amount received pursuant to the incurrence of a liability in an actual exchange transaction. Historical cost is an entry price and can only be used when measuring initial amounts.

33. Use of historical cost, particularly with assets used in providing services, generally results in a cost-of-services amount that is relevant for assessing interperiod equity. However, use of historical cost presents challenges when presenting information about assets and liabilities that is comparable and useful for assessing financial position. Assets and liabilities presented at historical cost reflect the prices at the dates of transactions, rather than at the date of the financial statements. Consequently, amounts presented may reflect prices at multiple dates and may impede the ability to (a) compare this information with that of other entities, (b) understand the service potential embodied in assets, and (c) assess the amount of resources that will be required to satisfy liabilities.

34. Historical cost typically is an amount that is readily determinable with minimal cost, is considered to be understandable and reliable, and does not adversely affect the timeliness of financial reporting. At times, however, complications such as application of

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<sup>3</sup>*Historical cost* is the term most appropriate for assets; *historical proceeds* is the term most appropriate for liabilities. For the purposes of this Concepts Statement, however, *historical cost* is used when referring to both assets and liabilities.

different cost accounting methodologies, allocation of costs in a single transaction to the multiple items acquired, or reductions in original cost reported to represent the estimated usage of an asset over time, can reduce the understandability and reliability of the reported measure.

## **Fair Value**

35. 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. As such, fair value is an exit price. The market to which the definition of fair value refers is the principal market or, when there is not a principal market, the entity's most advantageous market. For nonfinancial assets, the price should represent the value of the asset at its highest and best use as determined by market participants. The highest and best use notion takes into account uses that are physically possible, legally permissible, and financially feasible. For liabilities, the price should take into consideration the credit standing of the entity. Multiple valuation techniques may be used to measure fair value.

36. Fair value is suitable for use either as an initial amount or as a remeasurement amount. Fair value could be applied as an initial amount in circumstances in which a historical cost amount is not available, typically because the asset or liability did not arise from an exchange transaction or because the asset or liability was acquired in a group without amounts assigned to the individual assets and liabilities in the group. Relevance of the use of fair value to presenting information that promotes the objectives of financial reporting is tied to (a) whether it is applied as an initial amount or a remeasured amount and (b) the nature of the asset or liability being measured. The extent to which a fair value is understandable, reliable, and timely depends upon the techniques and inputs used to measure fair value. Comparability of information in a statement of financial position is improved when fair value is used as a remeasured amount. Fair value generally is not suitable for assets that will be used directly to provide services because fair value is an exit price and governments will not be selling or otherwise exiting from these assets.

## **Replacement Cost**

37. Replacement cost is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date. Replacement cost generally is considered to be suitable only for assets that will be used in providing services, rather than assets that will be converted to cash. Replacement cost is an amount that reflects an entry value. Because this measurement attribute reflects the entity-specific service potential of an asset, it may or may not reflect (a) the highest and best use of the asset from the perspective of market participants or (b) an identical asset. A measurement at the initial transaction date using the replacement cost measurement attribute is referred to as *acquisition value*. Acquisition value may be used in circumstances in which historical cost is not available, typically because the asset did not arise from an exchange transaction or because the asset was acquired as part of a group of items without values assigned to the individual items in the group.

38. Consistent with the considerations regarding the use of initial and remeasured amounts, the use of replacement cost in conjunction with the application of the remeasured approach generally results in a cost-of-services amount that is less relevant for assessing interperiod equity than the use of either acquisition value or historical cost. Use of replacement cost in conjunction with the application of the remeasured approach, however, provides information about assets that is more comparable and useful for assessing financial position. The cost of determining replacement cost, along with the effect on understandability, reliability, and timeliness of financial reporting, varies depending upon the specific method of determining the amount.

### **Settlement Amount**

39. Settlement amount is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market. A settlement amount can be either (a) the amount that the counterparty would accept to settle the liability or would pay to satisfy a receivable at the date of the measurement or (b) the amount that will be realized from an asset or will be needed to liquidate the liability in due course according to the terms of the arrangement between the government and the counterparty. A settlement amount may be an undiscounted amount (which generally is the case for assets and liabilities with short durations) or a discounted amount (which generally is the case for assets and liabilities with long durations). In circumstances in which the acquisition of an asset or incurrence of a liability is related to activities that occur in multiple reporting periods, a settlement amount also may be a proportion of the amounts expected to be received or paid. Settlement amount generally is not appropriate for assets and liabilities (a) for which there is no counterparty or (b) that are likely to be realized or settled through a transaction in a market. A measurement of a liability at the initial transaction date using the settlement amount measurement attribute is sometimes referred to as *acquisition value*.

40. Settlement amount can be used in either an initial measurement approach or a remeasured approach. When used as a remeasured amount, settlement amount provides more relevant information for use in assessing an entity's financial position and information that is more comparable with information of other entities. The cost of determining settlement amount, along with the effect on understandability, reliability, and timeliness of financial reporting, varies depending upon the nature of the asset or liability being measured and the relative certainty or uncertainty of projected cash flows and other inputs to the measurement.

## Appendix A

### BACKGROUND INFORMATION

41. The existing components of the GASB's conceptual framework include Concepts Statements No. 1, *Objectives of Financial Reporting*; No. 2, *Service Efforts and Accomplishments Reporting*, as amended by No. 5, *Service Efforts and Accomplishments Reporting*; No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*; and No. 4, *Elements of Financial Statements*. Concepts on recognition and measurement of elements of financial statements are components necessary to complete the conceptual framework for reporting items in traditional financial statements (referred to as financial statements in this document).

42. A conceptual framework project on measurement attributes was added to the research agenda in December 2003, with a separate conceptual framework project on recognition added to the research agenda in August 2005. After considering feedback from the Governmental Accounting Standards Advisory Council (GASAC) at various meetings and the interrelatedness of the issues, the Board added a combined recognition and measurement attributes conceptual framework project to the research agenda in December 2005, with active deliberations on the current agenda beginning in December 2007.

43. During the period of the Board's deliberations on this project, the Federal Accounting Standards Advisory Board (FASAB) also was considering a conceptual framework project on measurement. The Board and the FASAB monitored each other's progress in their respective projects and coordinated with each other as appropriate. In August 2008, the Board met jointly with the FASAB and discussed measurement attributes and their relationship to the objectives of financial reporting. At its February and March 2010 meetings, the Board reviewed the FASAB's draft measurement concepts, which were developed by the FASAB using the Board's draft measurement concepts as a starting point, with various changes necessary to adapt the document to the federal government environment. The Board obtained input on some of the unique features of the federal government environment in order to better understand the differences between the two drafts. At a June 2010 joint meeting, the Board and the FASAB tentatively agreed to harmonize the use of the terms *measurement approaches* and *measurement attributes* in their respective projects. The FASAB issued Statement of Federal Financial Accounting Concepts 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, in August 2011.

44. From December 2007 through June 2011, the Board discussed and reached tentative conclusions on conceptual issues of recognition and measurement. The Board considered comments received from members of the project task force—comprising experts broadly representative of the GASB's constituency—throughout the development of this document. In addition, the Board regularly updated the GASAC on project developments and received feedback from GASAC members during the GASAC's regular meetings.

45. In June 2011, the Board issued the Preliminary Views, *Recognition of Elements of Financial Statements and Measurement Approaches*. Thirty-eight organizations and individuals responded to the Preliminary Views. In October 2011, the Board held three public hearings on the proposals put forth in the Preliminary Views. In addition, 20 users of financial statements were interviewed regarding their views on the proposals in the Preliminary Views. The Board's consideration of these issues and response to this input are reflected in the Basis for Conclusions.

46. In December 2012, the Board decided that the project would be separated into two subprojects: measurement and recognition. Separate Exposure Drafts and Concepts Statements will be issued for each subproject.

## **Appendix B**

### **BASIS FOR CONCLUSIONS AND ALTERNATIVE VIEW**

#### **Introduction**

47. This appendix summarizes factors considered significant by the Board members in reaching the conclusions in this Concepts Statement. It includes discussion of the alternatives considered by the Board and the reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

#### **Change in Focus of Measurement Concepts**

48. In the 2011 Preliminary Views, *Recognition of Elements of Financial Statements and Measurement Approaches*, the Board proposed certain specific views on measurement approaches. These views included the following:

- Initial amounts are more appropriate for assets that are used directly in providing services.
- Remeasured amounts are more appropriate for assets that will be converted to cash (for example, financial assets).
- Remeasured amounts are more appropriate for variable-payment liabilities, such as compensated absences or pollution remediation obligations.

As part of redeliberating the issues of measurement of elements of financial statements, the Board decided not to formalize these preliminary views as concepts and to change the focus of the measurement concepts. The Board decided that this Concepts Statement should focus on high-level measurement concepts only and as such exclude identification of circumstances in which one measurement approach might be more appropriate than the other. The Board determined that it was not appropriate for this Concepts Statement to place limitations on the selection of a measurement approach for any broad category of assets or liabilities. Rather, selection of a measurement approach is part of setting standards for accounting and financial reporting of assets and liabilities. Additionally, the measurement concepts were expanded to include a discussion of measurement attributes.

#### **Evaluation of Measurement Approaches**

##### **Balancing Competing Objectives of Financial Reporting**

49. The process of evaluating features of different measurement approaches may produce difficult choices, especially when evaluating the relevance of the information produced by application of the measurement approach to the promotion or achievement of the objectives of financial reporting. The information in a statement of financial position contributes to meeting some of the objectives of financial reporting, and the

information in a resource flows statement contributes to meeting other objectives of financial reporting.

50. When the most appropriate measurement approach for objectives associated with a statement of financial position differs from the most appropriate approach for objectives associated with a resource flows statement, a difficult choice is necessary. Conceptually, the statement of financial position and the resource flows statement are both important, yet because a single measurement approach is required to be selected for a particular transaction, the choice may indicate which financial statement is more important in that circumstance. For example, initial amounts generally have less relevance than remeasured amounts when evaluating the statement of financial position to assess the level of services that can be provided by a government. However, initial amounts generally have more relevance than remeasured amounts when evaluating the cost-of-services information that is presented in a resource flows statement. In this circumstance, the Board believes that cost-of-services information is more important than the information about the level of services that can be provided by the government. The Board believes this because of the essential role of the resource flows statement in providing decision-useful information about the results of the activities of a government and in demonstrating accountability. In other conflicting circumstances, the Board may conclude that the information presented in the statement of financial position is more important than the resultant information presented in the resource flows statement.

### **Cost of Services**

51. When evaluating the measurement approaches and whether they are consistent with the objectives of financial reporting—one of which is providing information about the cost of current-year services—the Board concluded that use of initial amounts is more consistent with reporting cost of services in a manner that reflects the concept of interperiod equity. The Board noted that cost of services can be determined using remeasured amounts and, if so, different information would be reported.

52. Application of remeasured amounts to assets used in providing services would result in a cost-of-services measurement that would be based, in part, on hypothetical costs that have not been incurred by the government. In inflationary periods, depreciation included in cost of services based upon remeasured amounts would exceed depreciation included in cost of services based on initial amounts. If current-year taxpayers were to provide resources sufficient to cover the cost of services based upon remeasured amounts, resources beyond those needed to recover the cost of acquisition of the assets would be accumulated. Some may view this as a way of avoiding the potentially large year-to-year increases in cost of services when large, long-lived service assets are replaced. Information about remeasured amounts of assets used in providing services is valuable for many purposes, such as assessing whether adequate funds or financing may be available for replacement of such assets to provide for continuity of services. The Board concluded that use of remeasured amounts for these assets is more oriented with policy decisions and planning, and use of initial amounts is more reflective of management's actions during the year—that of using assets acquired in prior years to provide services in the current year.

## **Evaluation of Understandability**

53. The Board concluded that the understandability of reported measurements and potentially associated remeasurement gains and losses varies depending upon the nature of the asset or liability. For example, capital assets generally are not remeasured because the government needs to employ the capital asset to continue to provide services. In this circumstance, including a remeasurement gain (or loss) with inflows of resources and outflows of resources for the period would not promote understanding of the activities of the period or assessment of interperiod equity. On the other hand, gains and losses from remeasurement of investments are more understandable. It is widely understood that the most relevant value associated with investments is how much cash they can generate if the assets were sold (a remeasured amount) rather than what was paid to acquire them (an initial amount). Gains and losses from remeasurement represent increases and decreases in the resources of a government during the reporting period.

## **Other Measurement Attributes Considered**

54. When considering which measurement attributes should be used to measure elements in the financial statements, the Board also considered *value-in-use*, which is the benefit to be obtained from the continuing use of an asset and from its disposal at the end of its useful life. This potential attribute was not considered to be sufficiently different from replacement cost, which is defined in this Concepts Statement to be an entity-specific value.

55. This Concepts Statement also does not present lower of cost or market value (LOCOM) as a measurement attribute. The Board views LOCOM as a multiple-attribute method that indicates the circumstances in which different measurement attributes should be applied. The Board also notes that LOCOM produces a biased measurement in that the lower of two values is selected. As such, LOCOM is inconsistent with the qualitative characteristic of reliability.

## **Constant-Dollar Accounting**

56. The Board recognizes that constant-dollar accounting is a concept that could have been included and discussed in a Concepts Statement on measurement. In constant-dollar accounting, reported amounts are restated using a common price index and, as such, can be applied with the use of either initial or remeasured amounts. In periods of high inflation, the relevance of unadjusted initial amounts decreases for many assets and liabilities. Consequently, reporting or disclosing values for assets and liabilities in constant, rather than nominal, initial dollars and potentially identifying gains and losses from changes in purchasing power separately from gains and losses from changes in specific prices may be beneficial in those circumstances. However, the Board determined that exploring this concept was not consistent with the primary objective of the measurement portion of the conceptual framework.

## Alternative View

57. One member of the Board believes that the Concepts Statement overstates the virtues of initial amounts and understates the advantages of remeasured amounts. In particular, this member believes that contrary to what is asserted in the document (paragraph 17) the use of initial amounts for assets that affect the cost of services is not consistent with the objective of providing the information necessary to assess interperiod equity. Further, this member contends that, in contrast to the document's claim that fair value generally is not suitable for assets that will be used to provide services (paragraph 36), fair value informs virtually all decisions involving such assets and is therefore highly appropriate for such assets.

58. Interperiod equity—the concept that current-year revenues should be sufficient to pay for current-year services—is intended to indicate whether a current generation of taxpayers is bearing the cost of the services that it enjoys today as opposed to shifting the cost to taxpayers in the future. As noted in Concepts Statement 1, interperiod equity is designed to encourage governments to “live within their means.”

59. This member believes that the concept of interperiod equity has meaning mainly to the extent that the cost of current-year services represents the economic value (that is, a current, remeasured value) of the resources used to provide those services. Thus, the cost should be indicative of the economic sacrifice that the entity made by using an asset in the chosen way rather than by either selling it or using it in an alternative manner. Initial amounts—the amount paid for a resource, perhaps in the distant past—provide no indication of the economic sacrifice either incurred by current taxpayers or to be demanded from taxpayers in the future.

60. This member demonstrates by way of an example the conceptual flaw in using initial amounts to assess interperiod equity. A government's electric utility has fuel in a tank. Some of the fuel was acquired in previous years for \$4 per gallon; some, at its current fair value of \$5 per gallon. It should be obvious that the costs to be borne—the economic sacrifices to be made—by both current and future taxpayers or ratepayers should be unaffected by an artificial accounting assumption (such as first-in, first-out) as to which fuel the utility consumed first. The economic value of the fuel consumed is the same—its current fair value. It would be decidedly inequitable, therefore, to permit current taxpayers to cover the costs of resources consumed based on the older, in this example, lower price, while requiring the future taxpayers to bear the burden of covering the costs based on the newer, higher, price. Moreover, such measure of cost would hardly be consistent with the objective of encouraging governments to live within their means.

61. This member also takes exception to the statement that “fair value generally is not suitable for assets that will be used directly to provide services because fair value is an exit price and governments *will not* (emphasis added) be selling or otherwise exiting from these assets” (paragraph 36). This member observes that a key function of management (and hence, indirectly of citizens, legislators, and other users of financial statements) is to make ongoing assessments as to whether their government *should* exit from its assets used in providing services. The following examples illustrate this point. A school

district's officials should be considering whether to sell the district's downtown administration building and relocate to a lower cost area in an outlying area. A city's managers should be assessing whether certain of its vehicles should continue to be maintained and repaired or should be replaced with newer ones. A university should be considering whether it is economically advantageous to privatize certain services, selling its assets to the new service provider. For each of these decisions, as well as countless others, it is fair value, not initial value, that should be taken into account and is thereby the relevant (that is, appropriate) decision variable.

62. This member is concerned that this Concepts Statement, by claiming that initial costs are consistent with the concept of interperiod equity, will discourage future standards setters from requiring governments to present—whether in the basic financial statements or as supplementary disclosures—the information that is necessary to assess interperiod equity. Similarly, by declaring that fair value generally is not appropriate for assets that will be used in providing services, it will deter future standards setters from presenting data that are genuinely decision-relevant and thereby of value to statement users.

## Appendix C

### CODIFICATION INSTRUCTIONS

63. The section that follows updates the June 30, 2012, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Concepts Statement. Only the paragraph number of this Concepts Statement is listed if the paragraph will be cited in the Codification.

[Add to Appendix B as follows:]

#### GASB CONCEPTS STATEMENTS

#### APPENDIX B

##### Concepts Statement No. X

In [date], the GASB issued Concepts Statement No. X, *Measurement of Elements of Financial Statements*. Because Concepts Statements are not authoritative, this Statement has not been integrated into the Codification, but instead has been reproduced here (without appendices).

##### Measurement of Elements of Financial Statements

[Insert GASBCS X, ¶1–¶40.]

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