Institute of Chartered Accountants of New Zealand

STATEMENT OF CONCEPTS FOR GENERAL PURPOSE FINANCIAL REPORTING

1993

Issued by the Council, New Zealand Society of Accountants

CONTENTS

paragraph

Introduction
- Purpose 1.1
- Application 1.2
- Scope 1.4

Reporting Entity 2.1
The Objectives of General Purpose Financial Reporting 3.1
Qualitative Characteristics 4.1
- Relevance 4.2
- Understandability 4.5
- Reliability 4.9
- Comparability 4.13

The Assumptions Underlying the Preparation of General Purpose Financial Reports 5.1
Influences on Qualitative Characteristics
- Balance between Qualitative Characteristics 6.1
- Balance between Benefit and Cost 6.4
- Materiality 6.5
- Prudence 6.9

Definition and Recognition of the Financial Elements of General Purpose Financial Reports 7.1
- Financial Position 7.7
  - — Assets 7.7
  - — Liabilities 7.10
  - — Equity 7.15
- Financial Performance 7.19
  - — Revenues 7.19
  - — Expenses 7.22
- Other Changes in Equity 7.26
  - — Contributions by Owners and Distributions to Owners 7.27
  - — Capital Maintenance Adjustments 7.30

Definition and Recognition of the Non-financial Elements of General Purpose Financial Reports 8.1
• ... Definitions 8.2
• ... Recognition Criteria 8.5
Measurement Bases
• ... Financial Measurement 9.1
• ... Non-financial Measurement 9.12

1 INTRODUCTION

Purpose

1.1 This Statement sets out the concepts that underlie the preparation of general purpose financial reports for external users. Such reports may contain both financial and non-financial information. The purpose of the Statement is to:

(a) assist users to interpret the information contained in financial reports prepared in conformity with generally accepted accounting practice;

(b) assist preparers of financial reports to apply financial reporting standards and to deal with topics that are not the subject of a financial reporting standard;

(c) assist auditors to form an opinion as to whether financial reports provide a fair presentation of an entity's financial and service performance, financial position and cash flows; and

(d) assist the Financial Reporting Standards Board (the Board) to develop future financial reporting standards and to review existing financial reporting standards.

For the purposes of this statement the term *fair presentation* has the same meaning as *a true and fair view* and *fairly reflect*.

Application

1.2 This Statement applies to all general purpose financial reports.

1.3 The provisions of this Statement become operative for financial reports covering periods commencing on or after 1 January 1995.

Scope

1.4 This Statement details:

(a) the objectives of general purpose financial reporting;

(b) the qualitative characteristics that determine the usefulness of information in financial reports;

(c) the assumptions underlying the preparation of financial reports;

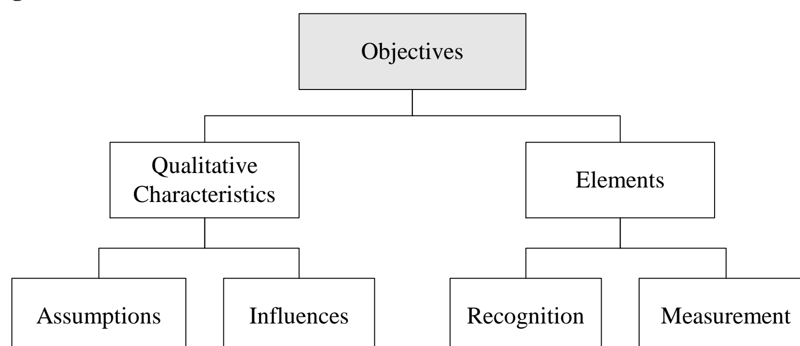
(d) influences on the preparation of financial reports;

(e) the definition of the elements from which financial reports are constructed; and

(f) the recognition and measurement of those elements.

The relationship between these matters is shown in Figure 1:

Figure 1



1.5 This Statement is concerned with *general purpose financial reports* (referred to as "financial reports"). Such financial reports are intended to provide information to meet the needs of external users who are unable to require, or contract for, the preparation of special reports to meet their specific information needs. As the transactions and events being reported may have both financial and non-financial effects, general purpose financial reports may contain both financial and non-financial information.

1.6 Some users may require, and have the power to obtain, information in addition to that contained in general purpose financial reports. Such *special purpose financial reports*, for example, computations prepared for taxation purposes, and trust deed reports for major lenders such as banks and financial institutions, fall outside the scope of this Statement.

2 REPORTING ENTITY

2.1 *A reporting entity exists where it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them in terms of the objectives stated in paragraph 3.1.*

2.2 An obligation to report often derives from legislation, regulations, common law, or contractual arrangements. However, the responsibility to report publicly is broader than the "legal" obligation and arises from:

(a) the role played in the community by the reporting entity; and/or

(b) users' reliance on general purpose financial reports for their information needs.

2.3 The following are examples of users who may be dependent on an entity's general purpose financial reports:

(a) providers of resources to such entities: for example, suppliers, lenders, investors, tax payers or donors;
(b) representatives of groups such as voters or shareholders whether the representatives be elected or appointed;
(c) analysts and members of the media concerned with analysing and reporting the performance of entities.

3 THE OBJECTIVES OF GENERAL PURPOSE FINANCIAL REPORTING

3.1 The objectives of general purpose financial reporting are to provide information to assist users in:

(a) assessing the reporting entity's financial and service performance, financial position and cash flows;
(b) assessing the reporting entity's compliance with legislation, regulations, common law and contractual arrangements, as these relate to the assessment of the reporting entity's financial and service performance, financial position and cash flows; and
(c) making decisions about providing resources to, or doing business with, the reporting entity.

Thus financial reporting has an accountability role [parts (a) & (b)] and an informative role [part (c)]. The relative importance of these roles may vary for different users and in different sectors. For example, because many public sector entities exercise particular powers, the users of public sector general purpose financial reports may be more interested in accountability.

3.2 The objectives of general purpose financial reporting outlined in paragraph 3.1 are most commonly achieved by publishing financial reports which cover:

(a) financial position;
(b) financial and service performance; and
(c) cash flows.

An entity's performance is assessed by comparing the entity's financial results with its financial objectives and comparing the entity's service performance results with its service performance objectives.

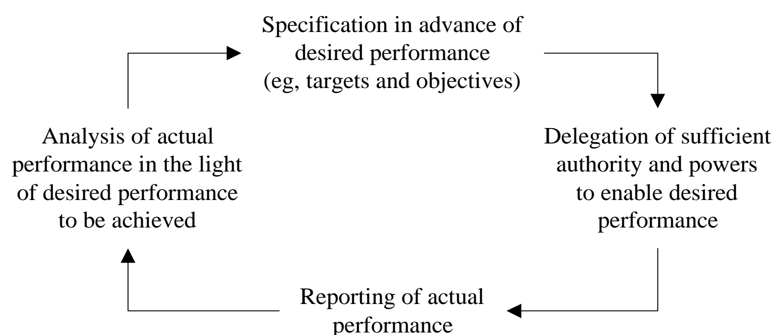
Service performance objectives and results are reported in non-financial terms, such as quantities of goods and services provided. Financial results and objectives are reported in financial terms such as financial surplus.

Where service performance objectives predominate, entities report primarily in non-financial terms. Entities report primarily in financial terms where financial

objectives predominate (as for example most private sector for-profit entities). In the public sector, many entities have both service performance objectives and financial performance objectives.

3.3 Accountability is the requirement for one party to account to another party for its performance over a given period: for example, directors are accountable to shareholders, Parliament holds Ministers to account. The four components of accountability are outlined in Figure 2.

Figure 2



3.4 To fulfil the accountability role, financial reports should reflect the nature and dimensions of performance that are relevant to the entity.

3.5 Accountability requires that financial reports:

(a) identify the objectives and targets normally established by formal process; and

(b) measure actual achievements against those objectives and targets.

Such objectives and targets may be financial or non-financial.

3.6 Traditionally, financial reporting has focused on providing information about past transactions and events. To meet the objectives stated in paragraph 3.1, the entity might usefully supplement historical information by providing:

(a) interpretive comment on the financial information supplied; and

(b) prospective information.

3.7 Interpretive comment could point out the relationship between material changes in financial elements and the entity's history, current activities, external environment or objectives. Narrative, for example, can provide information about an entity's physical resources, resulting in improved understanding of the entity's financial position. Narrative comment is particularly relevant in reporting service performance.

3.8 Prospective information could take either narrative or quantitative form. Narrative information could provide an assessment of the entity's prospects, focusing on how anticipated changes in the economic environment might affect results, liquidity and risk. Quantitative information could take the form of predictive results for operations, financial position and cash flows, based on assumptions about future economic conditions and courses of action. For example, local government budgets usually set the basis of a rate, levy, user charge or other source of funding. Further, the publication of financial budgets and other prospective information at the beginning of a reporting period, and the later comparison with actual results, are essential to the accountability of public sector entities.

4 QUALITATIVE CHARACTERISTICS

4.1 The quality of the information provided in financial reports determines the usefulness of those reports to users. The characteristics by which quality can be measured are:

(a) relevance;

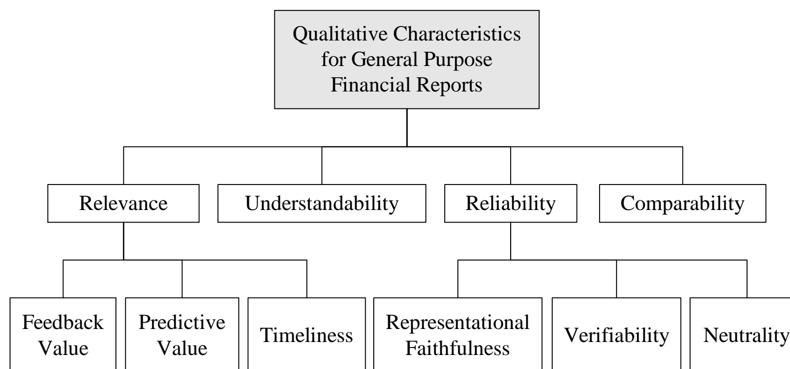
(b) understandability;

(c) reliability; and

(d) comparability.

The qualitative characteristics discussed in this Statement are represented in Figure 3:

Figure 3



Relevance

4.2 *Information is **relevant** to users if it can be used to:*

(a) confirm or correct prior expectations about past events (feedback value); or

(b) assist in forming, revising or confirming expectations about the future (predictive value).

4.3 A particular piece of information may have **feedback value** only — for example, information on compliance with a debenture trust deed — or both feedback and **predictive value** — for example, information on which to base predictions about the current level and structure of asset holdings provides:

(a) feedback about past predictions of the way the entity would restructure; and

(b) information about the entity's ability to absorb future economic shocks.

4.4 **Timeliness** is an ingredient of relevance, because if information is not available when it is needed, it is of no use.

Understandability

4.5 *Information is **understandable** when users might reasonably be expected to comprehend its meaning.*

4.6 The users' ability to understand financial information will depend in part on their own capabilities and in part on the way in which the information is presented.

4.7 For the purpose of this Statement, users are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, and to be willing to study the information with reasonable diligence.

4.8 Information about complex matters should not, however, be excluded from financial reports merely because it may be too difficult for some readers to understand.

Reliability

4.9 *Information is **reliable** when it:*

(a) corresponds with the actual underlying transactions and events (representational faithfulness);

(b) is capable of independent verification (verifiability); and

(c) is free from bias (neutrality).

4.10 **Representational faithfulness** is achieved when transactions and events which affect the entity are presented in financial reports in a manner that corresponds with the substance of the actual underlying transactions and events. That is, transactions and events are accounted for and presented in a manner that conveys their economic effect rather than necessarily their legal form.

4.11 Information is **verifiable** if knowledgeable and independent observers could be expected to concur that the presentation of a transaction or event agrees, with a reasonable degree of precision, with the actual underlying transaction or event. Verifiability focuses on whether a particular basis of measurement is correctly applied, rather than on whether it is appropriate.

4.12 Financial reports are **neutral** if the preparer has not, in order to achieve a predetermined result, selected or presented information in a manner designed to influence the making of decisions or judgement.

Comparability

4.13 *Information in a financial report is* ***comparable*** *when users are able to identify similarities and differences between that information and information in other reports.*

4.14 Comparability applies to the:

(a) comparison of financial reports of different entities; and

(b) comparison of the financial reports of the same entity over periods of time.

4.15 An important implication of the concept of comparability is that users need to be informed of the policies employed in the preparation of financial reports, changes in those policies and the effects of those changes.

4.16 Because users wish to compare the performance of an entity over time, it is important that financial reports show corresponding information for preceding periods.

5 THE ASSUMPTIONS UNDERLYING THE PREPARATION OF GENERAL PURPOSE FINANCIAL REPORTS

5.1 Unless there are special circumstances, preparers of financial reports should usually apply the following assumptions:

(a) the entity is a **going concern**

(b) the entity's economic activity can be divided into nominated time periods (**period reporting**)

(c) the entity's revenue and expenditure are reported on an **accrual basis.**

5.2 *Going Concern:* Financial reports are normally prepared on the assumption that the entity will continue in existence for the foreseeable future. In particular, this means that there is no intention or necessity to liquidate or significantly curtail the scale of the entity's operations. If such an intention or need exists, it may be inappropriate to prepare financial reports on a going concern basis and, if so, the different basis on which the reports are prepared should be disclosed.

5.3 When assessing whether an entity will continue in existence for the foreseeable future, consideration should be given to changes in circumstances which are likely to occur during a period of at least one year from the date on which the financial report is approved, and to changes in circumstances which the entity knows will occur thereafter. The going concern assumption will need careful interpretation in some public sector instances. For example, the power to rate or tax may allow some public sector entities to be considered as a going concern even though they may operate for extended periods with negative equity.

5.4 *Period Reporting*: An entity's results and financial position can best be measured at the time of that entity's liquidation. However, in the case of a going concern, in order to provide timely information, it is assumed that the entity's

economic activity can be divided into nominated time periods. This requires the preparer to determine which time period each transaction or event relates to, and to resolve any difficult allocation problems.

5.5 *Accrual Basis:* Under the accrual basis, the effects of transactions and other events are recognised when they occur. They are then recorded in the accounting records, and reported in the financial reports, of the periods to which they relate. The time that event or transaction occurs may or may not coincide with the time that cash is received or paid. Financial reports prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash, but also of obligations to pay cash in the future and of resources that represent cash to be received in the future.

6 INFLUENCES ON QUALITATIVE CHARACTERISTICS

Balance between Qualitative Characteristics

6.1 A balancing, or trade-off, between qualitative characteristics is often necessary.

Generally, the aim is to achieve an appropriate balance in order to meet the objectives of general purpose financial reports. Deciding the relative importance of the characteristics in different cases is a matter of professional judgement.

6.2 Information may be relevant, but so unreliable in nature or representation that its recognition in a financial statement is potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the entity to recognise the full amount of the claim in the statement of financial position, although it may be relevant to disclose the amount and circumstances of the claim in the notes to the financial report.

6.3 The preparers of financial reports may need to balance the relative merits of reporting in good time and providing reliable information. In order to provide timely information, it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable, but of little value to users who have had to make decisions in the interim.

Balance between Benefit and Cost

6.4 The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a matter of judgement. Furthermore, the costs do not always fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared. For these reasons, it is difficult to apply a benefit-cost test in any particular case. Nevertheless, standard-setters, as well as preparers and users of financial reports, should be aware of this constraint.

Materiality

6.5 A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time that the financial reports are completed, is likely to influence users of financial reports in making decisions or assessments.

For example, unusual increases in directors' or elected members' emoluments may be critical (because of the fiduciary responsibilities of those directors or officials), even though the absolute amounts of those emoluments may be much smaller than many other costs which do not need to be disclosed.

6.6 Determining the materiality of an item is essentially a matter of judgement. Materiality is concerned with assessing whether omission, misstatement, or non-disclosure of an item of relevant and reliable information could affect the perceptions of financial report users. Materiality applies to non-financial and narrative information as well as to the financial contents of general purpose financial reports.

6.7 Consideration should be given to the likely users of the particular financial reports, and to the information needs of those users. The information presented in financial reports may be used by various, and often quite different, categories of persons, each having its own particular interest in the reporting entity.

6.8 The assessment of materiality needs to be carried out not only in relation to individual items but also in relation to classes of similar items. For example, errors in individual items may be immaterial in their own right, but material in aggregate.

Prudence

6.9 The concept of **prudence** (or conservatism), often cited in accounting literature, has been explained as the need to exercise care when dealing with uncertainties. The preparers of financial reports have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial reports. Prudence requires that preparers exercise a degree of caution in making the estimates necessary to recognise such transactions and events, to ensure that assets or revenues are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses, because the financial reports would not be neutral and, therefore, not have the quality of reliability. Clearly such a misinterpretation is incompatible with the notion of representational faithfulness.

7 DEFINITION AND RECOGNITION OF THE FINANCIAL ELEMENTS OF GENERAL PURPOSE FINANCIAL REPORTS

7.1 Financial reports portray the effects of transactions and other events by grouping them into broad classes according to their economic characteristics in order to meet the objectives specified in paragraph 3.1. These broad classes are termed elements.

7.2 Financial elements relate to the reporting of financial position and financial performance.

7.3 The elements directly related to financial position are assets, liabilities and equity. The elements directly related to financial performance are revenues and expenses.

7.4 The definitions given in this statement show the interrelationship between the elements. This interrelationship means that an item that meets the definition and the criteria for recognition of a particular element, for example, an asset, automatically requires the recognition of another element, for example, revenue or a liability.

7.5 For the purposes of the recognition criteria set out in this document, the term "probable" means the chance of the service potential or future economic benefits arising on the basis of the available evidence or logic is more likely rather than less likely to occur.

7.6 The definitions in this section apply to all the measurement systems described in this document. Accordingly, in applying the definitions in any given set of circumstances, it is important to bear in mind the particular system which has been adopted.

FINANCIAL POSITION

Assets:

Definition of Assets

7.7 ***Assets*** *are service potential or future economic benefits controlled by the entity as a result of past transactions or other past events.*

Essential Characteristics of Assets

7.8 The definition of assets identifies three essential characteristics:

(a) there must be service potential or future economic benefits; and
(b) the entity must have control over the service potential or future economic benefits to the extent that the entity is able to enjoy the benefits, and deny or regulate access of others to the benefits; and
(c) the transaction or other event which gives rise to the entity's control over the service potential or future economic benefits must have occurred.

Criteria for Recognition of Assets

7.9 An asset shall be recognised in the statement of financial position when and only when:

(a) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and

(b) the asset possesses a cost or other value that can be measured with reliability.

Liabilities:

Definition of Liabilities

7.10 ***Liabilities*** *are the future sacrifices of service potential or of future economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events.*

Essential Characteristics of Liabilities

7.11 The definition of liabilities identifies three essential characteristics:

(a) there must be a present obligation, that is, the entity must have a duty or responsibility, which has not yet been satisfied, to act or perform in a certain way; and

(b) there must be adverse financial consequences for the entity, in that the entity is obliged to sacrifice service potential or future economic benefits to one or more other entities; and

(c) the transaction or other event which gives rise to the obligation to sacrifice service potential or future economic benefits must have occurred.

7.12 An obligation exists when the legal, social, political or economic consequences of failing to act or perform in the agreed way are such that the entity is left with little, if any, discretion to avoid the sacrifice of service potential or future economic benefits to one or more entities.

An obligation implies the involvement of two separate parties, namely the entity and a party external to the entity, since the same party cannot be both the recipient of the performance and the party under the duty to perform.

7.13 The existence of a liability at law is usually a clear indication of the existence of a liability for financial reporting purposes; however, the attributes of a legal liability may be unnecessarily restrictive in defining a liability for financial reporting purposes.

Criteria for Recognition of Liabilities

7.14 A liability shall be recognised in the statement of financial position when and only when:

(a) it is probable that the future sacrifice of service potential or future economic benefits will be required; and

(b) the amount of the liability can be measured with reliability.

Equity:

Definition of Equity

7.15 ***Equity*** *is the residual interest in the assets of the entity after deduction of its liabilities.*

7.16 Equity is measured as the difference between assets and liabilities.

7.17 Equity is a residual interest; that is, equity ranks after liabilities in claims to the assets of an entity. In the event of the entity being wound up, all liabilities must be met before a distribution of the remaining assets, called the net assets, can be made to those with ownership rights.

Recognition of Equity

7.18 Since equity is the residual interest in the assets of an entity and the amount assigned to equity will always correspond to the difference between the amounts assigned to the entity's assets and the amounts assigned to the entity's liabilities, the criteria for the recognition of assets and liabilities provide the criteria for the recognition of equity.

FINANCIAL PERFORMANCE

Revenues:

Definition of Revenues

7.19 ***Revenues*** *are inflows or other enhancements, or savings in outflows, of service potential or future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period.*

7.20 The probability of such inflows or other enhancements or savings in outflows of service potential or future economic benefits will vary. Assessments of the degree of certainty attaching to the inflows or other enhancements or savings in outflows of service potential or future economic benefits in any particular situation should be made on the basis of available evidence. For many entities, the majority of revenues will result from the provision of goods and services during the reporting period and the large majority of underlying transactions and other events will involve little or no uncertainty that an inflow or other enhancement or saving in outflows of service potential or future economic benefits has occurred, since the entity will either have received cash or have an explicit claim against an external party. However, an absence of an exchange transaction will often raise doubts about whether the requisite degree of certainty has been attained. In situations where there is uncertainty about the inflow or other enhancement or saving in outflows of service potential or future economic benefits, revenues are recognised when the inflow or other enhancement or saving in outflows is probable.

Criteria for Recognition of Revenues

7.21 Revenues shall be recognised in the determination of the result for the reporting period, when and only when:

(a) it is probable that the inflow or other enhancement or saving in outflows of service potential or future economic benefits has occurred; and

(b) the inflow or other enhancement or saving in outflows of service potential or future economic benefits can be measured with reliability.

Expenses:

Definition of Expenses

7.22 ***Expenses*** *are consumptions or losses of service potential or future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period.*

7.23 The consumptions or losses of service potential or future economic benefits that constitute expenses may be of various kinds; for example, service potential or future economic benefits will be consumed or will expire during the current reporting period as consumable stores are used, and there will be an outflow of service potential or future economic benefits in a future reporting period as a result of the incurrence, during the current reporting period, of a liability for some types of taxes. The transactions and other events from which expenses arise, and the expenses themselves, are in many forms and are referred to by a variety of names; for example, wages and salaries, depreciation and amortisation, cost of goods sold, cost of services provided, rent and interest.

Criteria for Recognition of Expenses

7.24 Expenses shall be recognised in the determination of the result for the reporting period, when and only when:

(a) it is probable that the consumption or loss of service potential or future economic benefits resulting in a reduction in assets and/or an increase in liabilities has occurred; and

(b) the consumption or loss of service potential or future economic benefits can be measured with reliability.

7.25 It has been common practice when recognising expenses in the statement of financial performance to make a direct association between costs incurred and specific items of revenue. This process, commonly referred to as the matching principle, is the linked recognition of revenues and expenses that result directly and jointly from the same transactions or other events. For example, using the matching principle, the various components of expense which make up the cost of goods sold are recognised in the statement of financial performance at the same time as the revenue derived from the sale of the goods. This approach may result

in recognition and/or classification decisions that are inconsistent with the definitions of elements adopted in this Statement. If the application of the matching principle would result in the recognition of items which do not meet the definition of assets or liabilities, it is inappropriate and not permitted.

OTHER CHANGES IN EQUITY

7.26 In identifying changes in the entity's financial position, users of a financial report need information about changes in the entity's equity during the reporting period that have not resulted from the entity's operations. These other changes may include non-reciprocal transfers to and from owners (distributions to owners and contributions by owners) and capital maintenance adjustments.

Contributions by Owners and Distributions to Owners

Definitions

7.27 ***Contributions by owners*** *means service potential or future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that establish a financial interest in the net assets of the entity which:*

(a) *conveys entitlement both to distributions of service potential or future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or*

(b) *can be sold, transferred or redeemed.*

7.28 ***Distributions to owners*** *means service potential or future economic benefits distributed by the entity to all or part of its ownership group, either as a return on investment or as a return of investment.*

7.29 Number Not Used.

Capital Maintenance Adjustments

Definition

7.30 ***Capital maintenance adjustments*** *are adjustments made under certain accounting models to the entity's capital to take account of the effects of price changes on the entity's assets and liabilities.*

7.31 The concept of capital maintenance adopted in the preparation of financial reports is concerned with identifying the capital to be maintained when determining the result for the reporting period.

8 DEFINITION AND RECOGNITION OF THE NON-FINANCIAL ELEMENTS OF GENERAL PURPOSE FINANCIAL REPORTS

8.1 The non-financial elements most commonly included in financial reports are those directly related to service performance — inputs, outputs and outcomes. Reports on service performance disclose the degree to which the reporting entity has met its service objectives.

Definitions

8.2 ***Inputs*** *are the resources used to produce the goods and services which are the outputs of the reporting entity.*

8.3 ***Outputs*** *are the goods and services produced by the reporting entity.*

8.4 ***Outcomes*** *are the impacts on, or consequences for, the community resulting from the existence and operations of the reporting entity.*

Recognition Criteria

8.5 The term “recognition” has a particular meaning with respect to financial elements and cannot appropriately be applied to non-financial elements. However, similar criteria should be used when deciding whether to incorporate either type of element into a financial report. A non-financial element should be included if:

(a) the item has an appropriate basis of measurement; and

(b) it can be reliably measured.

9 MEASUREMENT BASES

Financial Measurement

9.1 ***Financial measurement*** *is the process of determining the monetary amounts at which financial elements are to be recognised.*

9.2 A number of different measurement bases may be used in recording transactions and events. They include:

(a) *Historical cost.* Assets are recorded at the amount of cash or cash equivalents paid (or payable) or the fair value of the consideration given (or to be given), at the time of their acquisition.

Liabilities are initially recorded at the amount of proceeds received (or receivable) in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) *Current cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same, or an equivalent asset, was acquired currently. Liabilities are carried at the amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) *Realisable (settlement) value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal.

Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) *Present value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business.

Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

The interrelationship between elements means that revenues and expenses are measured on the same basis as the assets and liabilities to which they relate.

9.3 Choosing a measurement system for use in preparing general purpose financial reports has two aspects:

(a) selecting the measurement base, that is, the *dimension(s)* or *attribute(s)* of assets and liabilities that are to be measured; and

(b) selecting the *monetary unit* in which the measurements are to be expressed.

The alternative measurement bases were described in paragraph 9.2. The alternative monetary units are nominal dollars (that is, number of dollars) and constant dollars (that is, number of purchasing power units).

9.4 Paragraph 4.1 defined the qualitative characteristics of general purpose financial reporting as relevance, understandability, reliability and comparability. Different measurement systems are likely to meet the qualitative characteristics of general purpose financial reporting to different degrees and there will often be a trade-off between the qualitative characteristics. Moreover the trade-offs may differ according to the type of asset or liability concerned, so that a decision may have to be made as to whether users gain particular benefit from financial reports being prepared on a single measurement base, or whether it is acceptable to measure different items in the financial reports using different bases. Finally, preparation costs may vary as between alternative measurement systems, and these must be taken into account when addressing the balance between benefits and costs.

9.5 Initial recognition most commonly occurs as a result of a transaction such as the purchase of an asset. The measurement method for first recognition, therefore, will typically be a cost based method. Thus assets and liabilities are normally recorded initially at the transaction cost. There may be a further recognition stage which is referred to as remeasurement. Remeasurement involves changing the monetary amount at which an asset or liability is recorded when the recognition criteria for a change are met. Such a change will normally be attributable to events

rather than transactions, for example, the passing of time giving rise to the need for depreciation, the diminution in value of an amount owed by a debtor to allow for the possibility of a bad debt, or a change in value of a marketable security from that used in the initial transaction.

9.6 Measuring assets at monetary amounts is a process of valuation. Historical cost is the measurement base arising from traditional, transaction-based accounting and is used on initial recognition. For remeasurement the method used is usually a form of current value, based upon observations of current market values or the assessment of the current value of the benefits to be derived from using an asset. Current value will usually be the same as historical cost at the initial recognition stage, subsequent events causing the two to diverge at the remeasurement stage.

9.7 In preparing financial reports, reporting entities in New Zealand usually adopt historical cost as the initial measurement base and nominal dollars as the monetary unit. Application of the base is subject to:

(a) a recoverable amount test; and

(b) recognition of depreciation (amortisation) on non-current assets.

For example inventory is stated at historical cost or net realisable value, whichever is the lower; similarly, fixed assets are stated at the lower of depreciated historical cost and recoverable amount.

9.8 Except as described in paragraph 9.7 the historical cost system fails to recognise unrealised valuation changes and may thus provide an inadequate measure of financial performance. Regular remeasurement of all assets and liabilities would provide a more complete measure of financial performance which has sometimes been referred to as comprehensive income.

9.9 The combination of the historical cost system with the practice of remeasuring certain non-current assets to current value is known as the "modified historical cost" system[1]. This system is adopted by many entities in New Zealand. Subject to the considerations described in paragraph 9.4 above, the Board believes that the modified historical cost system meets the objectives of general purpose financial reporting better than the historical cost system.

9.10 As noted in paragraph 9.4 it is unlikely that any single measurement base can cater for every need or would be sufficiently reliable for financial reporting in all circumstances. Hence it is desirable to apply a system that chooses the measurement

---

[1] Under this system, the practice has in the past been to recognise valuation changes on a class of assets directly in a revaluation reserve which is a component of equity. If recognition of a valuation decrement resulted in a debit balance in the reserve for the class of assets concerned, the amount of the debit balance was treated as a loss. The result of this method has been that the statement of financial performance no longer interrelates with the statement of financial position.

base most appropriate to the circumstances. The Board will consider the most appropriate measurement base when developing financial reporting standards for specific elements. It is appropriate that financial reports prepared in accordance with this approach to measurement disclose fully the measurement bases which underlie the financial report and those relating to all material elements.

9.11 All valuation changes will be recognised in either the statement of financial performance or the statement of movements in equity. These statements will then interrelate with the statement of financial position. As it develops each financial reporting standard the Board will consider in which financial statement the recognition should be made.

Non-financial Measurement

9.12 Non-financial measurement is the process of determining quantitative representations of the non-financial elements of general purpose financial reports. The selection of a measurement base will depend on the nature of the item to be reported, but will commonly include dimensions of quantity, quality, location and time.

9.13 Any particular event or transaction may have both financial and non-financial attributes capable of measurement, and may therefore be included as both a financial element and a non-financial element in the general purpose financial reports. For example, a local authority's rubbish collection activity may be measured in financial terms, that is, the total cost of the activity, and in non-financial terms, for example:

(a) the number of households from which rubbish is collected;

(b) the frequency of the rubbish collection;

(c) the location from which the rubbish is collected;

(d) the extent to which recycling is encouraged.

SC