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Measurement of Assets and the Classical Measurement Theory

Value is an old concept. In 1776 Adam Smith defined value in two ways: it may express the utility of some particular object and it may express the power of an object to purchase other goods. Therefore, it is surprising that valuation is not defined in the recent accounting literature at all. What is even more surprising is that until the 1960s the term "valuation" was extensively used, and after that it practically disappeared. Why? The reason may have been in the adoption of the term "measurement". The term "valuation" was replaced by the term "measurement". This terminological shift was observed by Griffin et al. (1971) as they stated: '"Valuation" is generally used in accounting in reference to the process of applying specifiable methods which result in the assignment of numbers to represent economic properties. Thus perceived, the term valuation is essentially synonymous with the term measurement.'

In the 1960s measurement was introduced to accounting with high hopes. Many even expected a revolution (Bierman, 1963). The term "revolution" was never elaborated, but it probably referred to the predictive value of information following the example of the natural sciences. However, the revolution never ensued. The main reason for this disappointment may have been that it was the modern view of measurement that was adopted, not the classical one. The modern view is so allowing in its measurement rules that it amounted to hardly more than a shift in terminology: the term "valuation" was replaced by the term "measurement".

The motivation for this paper came from the observation that the IASB has moved in the direction of the classical measurement theory. IFRS 13 Fair Value Measurement is the most significant example of this because it puts such a great emphasis on making observations, which is precisely the emphasis that classical measurement theory makes. In line with this the aim of the paper was to elaborate on the key concepts of the classical measurement theory, to explain the implications of this theory for the concept of an asset, and finally to propose a new measurement-based classification of assets for financial reporting.

Measurement was defined as the effective assignment of numbers to numerically quantified properties of the object or event using the empirical operation of observation. One implication of this definition was that the value of assets cannot be measured unless the concept of an asset is modified. The current definitions make the value of all assets depend on the future, thus excluding the possibility of direct observation. This problem can be avoided either by introducing the basic resource as a unique asset having instrumental value or by reformulating the definition of an asset. For example, the definition in IASB Update (2006) could be

reformulated as follows: 'An asset is a present economic resource [*embodying actual or potential economic benefits*] to which an entity has a present right or other privileged access.'

If one does not want to reduce the amount of information currently released in financial reports, they will continue to consist of information that is based only in part on classical measurement. The other part will be based on forecasting and allocation. Measurements should be distinguished from forecasts and allocations because forecasts are more uncertain and allocations are more discretionary than measurements. Therefore the new five-category classification of assets suggested in this paper may help in assessing the riskiness of various asset groups and the riskiness of the firm. It may also help in making risk/return assessments. ■