Chapter 5

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are recognized and carried in the balance sheet and income statement. Measurement is defined as the assignment of numbers to the attributes or properties of objects being measured, which is exactly what accountants do.

Measurement of the effects of business transactions (events) is one of the most important accounting activities before the accounting information is communicated to users of information. Measurement is the assignment of numerals to objects or events according to rules. It is the assignment of numbers to characteristics or properties of objects being measured, which is exactly what accountants do. "Measurement in accounting has traditionally meant the assignment of numerical values to objects or events related to an enterprise and obtained in such a way that they are suitable for aggregation (such as the total valuation of assets) or disaggregation as required for specific situations. However, measurement also involves a process of classification and identification, and accountants have recognised the need for many years for the presentation of information that is nonquantifiable in nature, such as disclosure frequently placed in footnotes or elsewhere in the statements."

Measurement is related to valuation and recording and is a process of collecting various figures and information in the process of accounting measurement. The measurement has become a subject of research since the nineteenth century. Ever since measurement of accounting is multidimensional. Accounting and measurements differently interpret values and measurements.

MEASUREMENT IN ACCOUNTING

It is generally recognized that accounting is a measurement as well as a communication discipline. The financial accounting process consists of a series of accounting operations that are carried out systematically in each accounting period. The underlisted accounting operations although listed separately overlap conceptually among themselves and some of the accounting operations may be performed simultaneously. The broad operating principles guide these accounting operations may be listed as follows:

(1) **Selecting the events:** Events to be accounted for are identified. Not all events that affect the economic resources and obligations of an enterprise are, or can be, accounted for when they occur.
(2) **Analyzing the events:** Events are analyzed to determine their effects on the financial position of an enterprise.
(3) **Measuring the effects:** Effects of the events on the financial position of the enterprise are measured and represented by money amounts.
(4) **Classifying the measured effects:** The effects are classified according to the individual assets, liabilities, owners' equity items, revenue, or expenses affected.
(5) **Recording the measured effects:** The effects are recorded according to the assets, liabilities, owners' equity items, revenue, and expenses affected.
(6) **Summarizing the recorded effects:** The amounts of changes recorded for each asset, liability, owners' equity item, revenue, and expense are summed and related data are grouped.
(7) **Adjusting the records:** Remeasurements, new data, corrections, or other adjustments are often required after the events have been initially recorded, classified, and summarised.
(8) **Communicating the processed information:** The information is communicated to users in the form of financial statements.

DIFFICULTIES/LIMITATIONS IN ACCOUNTING MEASUREMENTS

There are some measurement constraints in accounting which make the accounting information less accurate and less reliable. Accounting information generated in financial accounting have the following limitations:

1 The objectives of financial reporting are affected not only by the environment in which financial reporting takes place but also by the characteristics and limitations of the kind of information that financial reporting, and particularly financial statements, can provide. The information is to a significant extent financial information based on approximate measures of the financial effects on individual business enterprise of transactions and events that have already happened; it cannot be provided or used without incurring a cost.

(2) The information provided by financial reporting is primarily financial in nature—it is generally quantified and expressed in units of money. Information that is to be formally incorporated in financial statements must be quantifiable in units of money. Other information can be disclosed in financial statements (including notes) or by other means, but financial statements involve adding, subtracting, multiplying, dividing numbers depicting economic things and events and require a common denominator. The numbers are usually exchange prices or amounts derived from exchange prices. Quantified nonfinancial information (such as number of employees or units of product produced or sold) and non-quantified information (such as descriptions of operations or explanations of policies) that are reported normally relate to or underlie the financial information. Financial information is often limited by the need to measure in units of money or by constraints inherent in procedures, such as verification, that are commonly used to enhance the reliability or objectivity of the information.

(3) The information provided by financial reporting pertains to individual business enterprises, which may comprise two or more affiliated entities, rather than to industries or an economy as a whole or to members of society as consumers. Financial reporting may provide information about industries and economies in which an enterprise operates but usually only to the extent the information is relevant to understanding the enterprise. It does not attempt to measure the degree to which the consumption of wealth satisfies consumer wants. Since business enterprises are producers and distributors of scarce resources, financial reporting bears on the allocation of economic resources to producing and distributing activities and focuses on the creation of, use of, and rights to wealth and the sharing of risks associated with wealth.

(4) The information provided by financial reporting often results from approximate, rather than exact, measures. The measures commonly involve numerous estimates, classifications, summarizations, judgements, and allocations. The outcome of economic activity in a dynamic economy is uncertain and results from combinations of many factors. Thus, despite the aura of precision that may seem to surround financial reporting in general and financial statements in particular, with few exceptions, the measures are approximations, which may be based on rules and conventions rather than exact amounts.

(5) The information provided by financial reporting largely reflects the financial effects of transactions and events that have already happened. Management may communicate information about its plans or projections, but financial statements and most other financial reporting are historical. For example, the acquisition price of land, the current market price of a marketable equity security, and the current replacement price of an inventory are all historical data—no future prices are involved. Estimates resting on expectations of the future are often needed in financial incorporated in financial statements is to measure financial effects of past transactions or events or the present status of an asset or liability. For example, if depreciable assets are accounted for at cost, estimates of useful lives are needed to determine current depreciation and the current undepreciated cost of the asset. Even the discounted amount of future cash payments required by a long-term debt contract is, as the name implies, a “present value” of the liability. The information is largely historical, but those who, use it may try to predict the future or may use the information to confirm or reject their previous predictions.

(6) Financial reporting is but one source of information needed by those who make economic decisions about business enterprises. Business enterprises and those who have economic interests in them are affected by numerous factors that interact with each other in complex ways. Those who use financial information for business and economic decisions need to combine information provided by financial reporting with pertinent information from other sources, for example, information about general economic conditions or expectations, political events and political climate or industry outlook.

(7) The information provided by financial reporting involves a cost to provide and use, and generally the benefits of information provided should be expected to at least equal the cost involved. The cost includes not only the resources directly expended to provide the information but may also include adverse effects on an enterprise or its shareholders from disclosing it. For example, comments about a pending lawsuit may jeopardize a successful defence, or comment about future plans may jeopardize a competitive advantage. The collective time needed to understand and use information is also a cost. Sometimes, a disparity between costs and benefits is obvious. However, the benefits from financial information are usually difficult or impossible to measure objectively, and the costs often are; different persons will honestly disagree about whether the benefits of the information justify its costs.