STAFF PAPER

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Project	**Post-implementation Review of IFRS 13 *Fair Value Measurement***
Paper topic	Research conducted during Phase 2 of the PIR

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Introduction

1. This paper summarises research staff completed in phase 2 of the Post-implementation Review (PIR) of IFRS 13 *Fair Value Measurement* (IFRS 13).

2. The research was undertaken with the objective of obtaining easily accessible information relating to the focus areas of phase 2 of the PIR, to supplement the academic literature review, and outreach activities, including the Request for Information. All the research was desk-based, using the research resources staff had pre-existing access to, predominantly AlphaSense, a subscription search engine used to search company financial reports and other publications.

3. The focus areas where research was conducted by staff were:

   (a) voluntary disclosures of quantitative sensitivity analysis for Level 3 fair value measurements (paragraphs 5–11);

   (b) highest and best use differing from current use (paragraphs 12–16); and

   (c) qualitative or quantitative disclosures about valuation adjustments (paragraphs 17–20).

4. This paper also refers to two research reports published by other organisations that have reviewed the application of IFRS 13 (paragraphs 21–28):

(a) *Review of Fair Value Measurement in the IFRS financial statements*[1], European Securities and Markets Authority (ESMA), July 2017; and

(b) *CR Common Practice: Fair value measurement information under IFRS*[2], Company Reporting, November 2017.

Voluntary disclosures of quantitative sensitivity analysis for Level 3 fair value measurements

Purpose of research

5. When conducting outreach during phases 1 and 2 of the PIR the staff found that preparers often questioned the usefulness of the quantitative sensitivity analysis disclosure for Level 3 measurements because it is the most costly disclosure to prepare.

6. Many stakeholders indicated that the requirement to disclose this analysis is a key difference between the converged Standards (IFRS 13 and Topic 820 *Fair Value Measurement).* The quantitative sensitivity analysis is not required

   (a) under US Generally Accepted Accounting Principles (US GAAP); and

   (b) for non-financial instruments under IFRS Standards.

7. The staff wanted to see whether any companies choose to disclose the quantitative sensitivity analysis voluntarily without being required to do so, as this could indicate that the information is perceived as useful.

Methodology and findings

8. To check for any instances of companies voluntarily reporting a quantitative sensitivity analysis for Level 3 fair value measurements the staff used the search

[1] The ESMA report can be found at: https://www.esma.europa.eu/press-news/esma-news/esma-reviews-application-ifrs-13-%E2%80%93-fair-value-measurement-requirements

[2] The Company Reporting report can be found at: https://www.companyreporting.com/browse/common-practices?utm_source=Company+Reporting+News+Update&utm_campaign=069fa4d2cb-EMAIL_CAMPAIGN_2017_11_16&utm_medium=email&utm_term=0_fc6fbb4773-069fa4d2cb-395865353

engine AlphaSens**e** to perform keyword searches of companies' financial statements.

9. To check for voluntary disclosures by IFRS reporting companies under IFRS Standards, the staff searched recent non-US companies' annual reports for 'IFRS', 'International Financial Reporting Standards' and 'sensitivity analysis' and 'investment property'. This was because anecdotal evidence had led the staff to understand that investment property is a class of non-financial asset where this analysis is sometimes voluntarily disclosed by entities. The staff found evidence that some companies with investment properties are disclosing quantitative sensitivity analysis voluntarily. The staff reviewed only a few financial statements and thus we do not have an indication of the proportion of companies providing the disclosure voluntarily.

10. The presence of this disclosure by some companies for a class of asset where it is not required could imply that the preparers have judged it to be useful to investors, or that investors have requested the information.

11. To check for these voluntary disclosures amongst US GAAP reporting companies the staff searched for the phrase 'sensitivity analysis' in the financial statements of American listed companies for the preceding 12 months. The search found no companies that apply US GAAP who report this disclosure voluntarily.

Highest and best use differing from current use

Purpose of research

12. During outreach in phase 1 of the PIR, stakeholders indicated that they were concerned about the implications of applying highest and best use (HBU) in the measurement of operating assets (i.e. assets could be measured at nil when using a residual method for a group of assets). Some other stakeholders however commented that the issue is not pervasive.

13. The staff researched whether there are frequent instances of companies reporting the valuation of HBU differing from the current use of an asset.

Methodology and findings

14. The staff used AlphaSense to search the following key terms: ‘current use’, ‘existing use’, ‘highest and best use’, and ‘highest best use’, across the annual reports of companies in all jurisdictions over the preceding 12 months.

15. The search results contained 587 companies, however upon initial scanning it became clear that most companies had simply reported boilerplate text about the fact the HBU test is a requirement of fair value measurement under IFRS, and so the majority of the results were false hits.

16. The staff reviewed in detail the disclosures of 60 companies out of the 587, which constituted a representative sample of geographies, industries and entity sizes. The staff found one company that reported measuring non-financial assets at a HBU that differs from its current use.

Disclosures about valuation adjustments

Purpose of research

17. During phase 1 of the PIR, several stakeholders stated that they had seen the inclusion of credit valuation adjustments (CVA) and debt valuation adjustments (DVA) in the fair value measurement of financial instruments, and that the quality of the measurement of these adjustments varied depending on an entity’s sophistication and the availability of valuation skills or resources. For example, most financial institutions including CVA and DVA in the fair value measurement of their financial instruments but fewer corporates doing so.

18. The staff sought to understand what disclosures, quantitative or qualitative, companies reported regarding these adjustments.

Methodology and findings

19. The staff used AlphaSense to search financial institution’s financial statements for the following keywords: ‘credit valuation adjustment(s)’, ‘debit valuation adjustment(s)’, ‘funding valuation’, ‘x value’, ‘capital value’, ‘CVA’, ’DVA’ and ‘KVA’.

20. The search returned 311 companies with various disclosures for these terms, of which the staff reviewed over 5% of the company's disclosures. The staff found that about half of the companies provided narrative about valuation adjustments and some form of numerical value for the adjustments (i.e. in the paragraphs with the narrative description or in a tabular format). Some of these reports indicated CVA/DVA as a significant unobservable input.

Reports that review the application of IFRS 13

ESMA Report on Review of Fair Value Measurement in the IFRS financial statements

21. In July 2017, ESMA issued a report, which included the analysis of the implementation of IFRS 13 by 78 European issuers. The report assessed the level of compliance with the requirements in IFRS 13 and the comparability amongst the entities.

22. The report focused on similar points to the RFI and gave the overall conclusion that the requirements of the Standard have been 'well incorporated in the financial statements'. However, the report did recommend to issuers that they provide more transparency on how they apply judgements.

23. The ESMA report also reviewed the application and disclosure information regarding valuation adjustments and recommended that the Board continue to monitor practice for developments in this area.

Company Reporting Common Practice: Fair value measurement information under IFRS

24. In November 2017, Company Reporting issued a CR Common Practice report on IFRS 13 reviewing 139 large public limited companies. The report analyses how IFRS 13 requirements have been put into practice both in terms of measurement and disclosure.

25. The report comments on the different locations of the disclosures of fair value measurement in the notes to financial statements. For instance, disclosures relating to the description of valuation techniques used for Level 3 assets and

liabilities are sometimes found in a separate fair value note or added into the significant accounting policies note in the financial statements.

26. The report also highlights that in a majority of fair value measurement disclosures the tabular format is the presentation format used for many disclosures and is 'clearer and more concise than a narrative note'. The report mentions this for the disclosure of the fair value hierarchy, the quantitative significant unobservable inputs of Level 3 measurement and the reconciliation of Level 3 measurements.

27. The report also indicates that the level of aggregation varies in the reporting of the fair value disclosures, specifically in the quantitative sensitivity analysis disclosure of Level 3 measurements.

28. Finally, the report indicates that 11 companies voluntarily disclose a quantitative sensitivity analysis for non-financial assets.