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International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**16 September 2008, London**
Subject:	**Credit crisis: Proposed amendments to IFRS 7 fair value disclosure requirements (Agenda paper 2B)**

Introduction

1 The fair value measurement project will address disclosures related to fair value measurement for all assets and liabilities measured at fair value. The proposed disclosures related to financial instruments have been accelerated to be addressed in a comprehensive disclosure package to amend IFRS 7 *Financial Instruments: Disclosures* as a result of the current market environment.

2 In recent months, several recommendations have been made for improving the disclosures about the fair value of financial instruments in markets that are no longer active. For example, the Financial Stability Forum's report on Enhancing Market and Institutional Resilience (published in April 2008) recommends that the IASB strengthen its standards to achieve better disclosures about valuations, methodologies and the uncertainty associated with valuations (Recommendation III.5).

3 The staff has analysed the recommendations made by various parties (eg users, auditors, regulators and others, including the IASB's expert advisory panel

members[1]). The recommendations that relate to the credit crisis are summarised below. Recommendations that deal with the long-term fair value measurement project generally will not be included in the comprehensive disclosure package, but will be considered for the exposure draft of an IFRS on fair value measurement. These recommendations are categorised as follows:

a clarifying the fair value hierarchy in IFRS 7;

b providing more direction on the form of the fair value disclosures, including references to a quantitative tabular format for disclosures;

c requiring a reconciliation from period to period for fair value measurements using significant unobservable inputs; and

4 The staff thinks a solution needs to be found that:

a improves the disclosures about fair value measurement;

b promotes consistency in disclosures, and therefore comparability, across entities, both within IFRSs and between IFRSs and US GAAP;

c reflects market practice that is consistent with the accounting and disclosure requirements;

d causes the least confusion with differences in wording between IFRSs and US GAAP; and

e achieves these goals with minimal effort (both for the Board and for people working with IFRSs), as this is an interim solution.

5 It should be noted that the staff has drafted a summary of the discussions of the expert advisory panel with regard to disclosures. That document will be available on the IASB Website. That document will not amend existing disclosure requirements or impose new requirements. On the other hand, the disclosure recommendations of the staff in this Agenda Paper relate to amendments to IFRS 7 and would be mandatory.

[1] The IASB formed the expert advisory panel in May 2008 in response to the recommendations by the Financial Stability Forum in its report Enhancing Market and Institutional Resilience, published in April 2008. The expert advisory panel addressed the measurement and related disclosures of financial instruments when markets are no longer active. See Agenda Paper 4 for a summary and update of the expert advisory panel's activities.

In developing the recommendations in this paper, the staff kept in mind the discussions of the panel.

Clarifying the fair value hierarchy in IFRS 7

6 Many users of financial statements have suggested that IFRS 7 should include a specific, three-level fair value hierarchy like that in FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157). Appendix 1 describes the fair value hierarchy in SFAS 157 and Appendix 2 describes the hierarchy in IAS 39 *Financial Instruments: Recognition and Measurement.*

7 With the implementation of IFRS 7's fair value disclosures, many entities have begun using a three-level hierarchy that is broadly consistent with that in SFAS 157. The three levels (or categories) include:

a **fair values measured using quoted prices in active markets**. These are unadjusted prices quoted in active markets for *identical* assets or liabilities. However, in the absence of detailed guidance in IFRSs, a minority of entities appear to be including in this category prices quoted in active markets not only for *identical* assets or liabilities, but also for *similar* assets or liabilities.

b **fair values measured using valuation techniques for which inputs significant to the fair value measurement are based on observable market data**. For many entities applying IFRSs, this includes (i) prices quoted in active markets for similar assets or liabilities and (ii) prices quoted in inactive markets for identical assets or liabilities. It also includes valuation techniques for which all significant inputs (inputs that have a significant effect on the valuation) are directly or indirectly based on observable market data.

c **fair values measured using valuation techniques for which inputs significant to the fair value measurement are based on unobservable market data**. This includes valuation techniques using at least one significant input (an input that could have a significant effect on the valuation) that is not based directly or indirectly on observable market data.

8 This three-level fair value hierarchy is broadly consistent with that in SFAS 157 and it seems entities are interpreting the significance of the inputs in broadly the same

manner as required in SFAS 157. However, although many entities restrict the first category (in (a) above) to pertain to unadjusted quoted prices for *identical* assets or liabilities, a few entities might use quoted prices for *similar* assets or liabilities. Clarifying what is in that category would improve comparability.

9 Furthermore, some entities might be tempted to recognise day one profits or losses even when a valuation technique uses some unobservable inputs, as long as those unobservable inputs are deemed to be insignificant to the measurement (category (b) above). Paragraph AG76 of IAS 39 states that an entity must use its transaction price at initial recognition unless the fair value of the instrument is based on an observable market transaction in the same instrument or 'based on a valuation technique whose variables include <u>only</u> data from observable markets' (emphasis added).

10 The staff has identified the following options for amending IFRS 7 to introduce a fair value hierarchy:

a **Option 1**: introduce the SFAS 157 fair value hierarchy into both IFRS 7 and IAS 39 *Financial Instruments: Recognition and Measurement*.

b **Option 2**: introduce the SFAS 157 fair value hierarchy into IFRS 7 only.

c **Option 3**: use the existing fair value hierarchy in IAS 39, which represents what some entities are doing in practice to comply with IFRS 7's disclosure requirements and IAS 39's hierarchy.

d **Option 4**: make no changes to IFRS 7 with regard to a hierarchy, but specify which instruments (or types of instruments) require more disclosure.

e **Option 5**: make no changes to IFRS 7. Instead, entities could use material from the disclosure section of the expert advisory panel document, which summarises the disclosures users of financial statements would find helpful, in addition to those required in IFRS 7.

Options 1 and 2 could either use the exact wording in SFAS 157 or could use similar wording, modified for the terminology used in IAS 39 and the staff's current plans for the wording to be used in the fair value measurement exposure draft.

11 The table on the following page summarises the advantages and disadvantages of each option.

12 The amount of resources necessary (both staff and Board time) declines for each option, with Option 1 requiring the most and Option 5 requiring the fewest.

Option	Description	Advantages	Disadvantages
1	Introduce the SFAS 157 fair value hierarchy into both IFRS 7 and IAS 39	• results in a direct link between the measurement and disclosures • achieves convergence with SFAS 157 (and increased comparability across entities) with respect to measurement and disclosures • hierarchy is identical to SFAS 157 if exact wording is used	• might change the fair value measurement of financial instruments before concluding deliberations in the fair value measurement project • if the exact wording in SFAS 157 is not used, entities following IFRSs and US GAAP might categorise measurements into different levels of the hierarchy • any wording changes as a result of subsequent discussions in the fair value measurement project might be confusing and could lead to disruption
2	Introduce the SFAS 157 fair value hierarchy into IFRS 7 only	• no risk of changing the fair value measurement for financial instruments before concluding the deliberations in the fair value measurement project • achieves convergence with SFAS 157 (and increased comparability across entities) with respect to disclosures • hierarchy is identical to SFAS 157 if exact wording is used	• no direct link between the measurement and disclosures • if the exact wording in SFAS 157 is not used, entities following IFRSs and US GAAP might categorise measurements into different levels of the hierarchy • any wording changes as a result of subsequent discussions in the fair value measurement project might be confusing and could lead to disruption

Option	Description	Advantages	Disadvantages
3	Use the existing hierarchy in IAS 39	• no risk of changing the fair value measurement for financial instruments before concluding the deliberations in the fair value measurement project • codifies current practice to use a three-level hierarchy in IFRSs to improve comparability with SFAS 157, which might increase convergence • maintains the link between the measurement and disclosures • uses terminology consistent with IAS 39, reducing confusion if the Board decides to use wording different from SFAS 157 in the fair value measurement project	• if the exact wording in SFAS 157 is not used, entities following IFRSs and US GAAP might categorise measurements into different levels of the hierarchy • having a three-level hierarchy in IFRSs with different terminology and labels from SFAS 157 might be confusing, even if they mean the same thing
4	Make no changes to IFRS 7 with regard to a hierarchy, but specify which instruments (or types of instruments) require more disclosure	• no risk of changing the fair value measurement for financial instruments before concluding the deliberations in the fair value measurement project • maintains the link between the measurement and disclosures • uses terminology consistent with IAS 39, reducing confusion if the Board decides to use wording different from SFAS 157 in the fair value measurement project	• might be difficult to specify which types of instruments need more disclosure without being prescriptive • analysts want 'Level 3' • some entities have already begun using a three-level hierarchy in IFRSs similar to that in SFAS 157; without specifying what that hierarchy is, entities might not be doing it consistently • does not achieve convergence with SFAS 157 with respect to disclosures • might not be necessary given the report summarising the expert advisory panel's discussions about disclosures

Option	Description	Advantages	Disadvantages
5	Make no changes to IFRS 7, and encourage entities to use material from the disclosure section of the expert advisory panel document	• no risk of changing the fair value measurement for financial instruments before concluding the deliberations in the fair value measurement project • maintains the link between the measurement and disclosures • uses terminology consistent with IAS 39, reducing confusion if the Board decides to use wording different from SFAS 157 in the fair value measurement project	• analysts want 'Level 3' • some entities have already begun using a three-level hierarchy in IFRSs similar to that in SFAS 157; without specifying what that hierarchy is, entities might not be doing it consistently • does not achieve convergence with SFAS 157 with respect to disclosures

13 This paper considers an interim solution to improve the disclosures about the fair value measurement of financial instruments as a result of the credit crisis. The fair value measurement project is ongoing and disclosures similar to those in SFAS 157 are likely to be in an IFRS on fair value measurement, when published.

14 The staff understands that users of financial statements have favourably received the three-level fair value hierarchy in SFAS 157. The IASB tentatively decided in June 2008 that the exposure draft of an IFRS on fair value measurement will contain a three-level hierarchy identical to the one in SFAS 157.

15 However, it is likely that some of the wording will differ, although they will be the same in principle (eg the wording for Level 3 of SFAS 157's hierarchy appears to have caused confusion in practice and an IFRS on fair value measurement might use different wording). It might be confusing for users and preparers of financial statements if the wording in an exposure draft on disclosures differs from that in SFAS 157 and/or the exposure draft on fair value measurement.

16 Furthermore, even if the fair value hierarchies in SFAS 157 and IAS 39 are broadly consistent, making wording changes to the hierarchy in IAS 39 might result in changes to the fair value measurement of financial instruments.

17 The staff therefore recommends not adopting the SFAS 157 hierarchy into IFRSs in the disclosure exposure draft. Instead, the staff thinks it would be better to clarify the current three-level fair value hierarchy in IFRS 7, which is based on the fair value hierarchy in IAS 39. This would result in changing IFRS 7 only, not IAS 39. This is Option 3 in the table above. The three-level fair value hierarchy would be:[2]

a fair values measured using quoted prices in active markets for identical assets or liabilities

b fair values measured using valuation techniques for which inputs significant to the fair value measurement are based on observable market data

[2] The staff uses 'category' and 'level' interchangeably in this document, although we prefer the term 'category' for IFRSs to avoid implying that they are exactly the same as the 'levels' in SFAS 157.

c fair values measured using valuation techniques for which inputs significant to the fair value measurement are based on unobservable market data

18 Because this hierarchy is broadly consistent with the hierarchy in SFAS 157, this increases convergence and users will be able to compare entities across jurisdictions.

Tabular format for quantitative disclosures

19 Users have responded favourably to the tabular disclosure of the fair values in SFAS 157. Appendix 3 contains the disclosure requirements in SFAS 157. They find it easy to compare across entities and within the same entity period-to-period. Some users and preparers view the equivalent disclosure requirements in IFRS 7 as *qualitative*, rather than *quantitative*. Many entities applying IFRS 7 provide a narrative description about the fair values of financial instruments, but not always in a format that allows easy comparison with other entities.

20 The following table provides an example of how such quantitative disclosures could be presented for financial assets (using the staff's recommendation about the fair value hierarchy):

CU million		**Fair value measurement at end of the reporting period based on:**[3]		
Description	**31/12/X1**	Quoted prices in active markets	Valuation techniques using inputs based on observable market data	Valuation techniques using inputs based on unobservable market data
Held-for-trading financial assets	115	105	10	
Derivatives	60	25	15	20
Available-for-sale financial assets	75	65		10
Total	250	195	25	30

21 The staff recommends providing more direction as to the *form* that quantitative disclosures should take. This could be achieved either by requiring that the information be presented in tabular format "unless another format is more appropriate to the circumstances of the entity", or by identifying tabular format as being an appropriate form of presenting the information.

[3] Although the tables in this paper use short-hand descriptions of the three-level hierarchy, the categories (levels) are those listed in paragraph 17.

Requiring a reconciliation from period to period

22 SFAS 157 requires a reconciliation of those fair value measurements that use significant unobservable inputs (ie SFAS 157's Level 3). Users have responded favourably to the resulting disclosures.

23 Some have suggested that similar information should also be disclosed for fair value measurements using significant observable inputs (ie SFAS 157's Level 2). They think such a disclosure would allow users to see movements between categories (levels). Others suggest requiring a narrative disclosure about this, because without the narrative description it will be difficult to understand into which other category (level) the instruments have moved and why. The staff thinks users would find the latter most useful.

24 The staff recommends requiring reconciliation from period to period of fair values using significant unobservable inputs and requiring a narrative description of the movements between categories (levels) and why. The following table provides an example of how such quantitative disclosures could be presented for financial assets:

CU million	**Fair value measurement at reporting date based on valuation techniques using inputs based on unobservable market data**		
	Derivatives	Available for sale financial assets	Total
Beginning balance	14	11	25
Total gains or losses			
Included in profit or loss	11	(3)	8
Included in other comprehensive income	4	0	4
Purchases, issuances and settlements	(7)	2	(5)
Transfers into and/or out of this category	(2)	0	(2)
Ending balance	20	10	30
The amount of total gains or losses for the period included in profit or loss attributable to the change in unrealised gains or losses relating to assets still held at the end of the reporting period	7	2	9

25 For fair values that are disclosed but not recognised, the staff recommends indicating the category (level) of the hierarchy in which the instrument falls.

Fair value disclosures for interim periods

26 IFRS 7 applies for annual periods. Some have suggested that the fair value disclosures also be required for interim periods under IAS 34. Appendix 4 to this paper summarises the disclosure requirements in IAS 34 for interim periods.

27 Paragraph 6 of IAS 34 states:

> In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. **The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.** [emphasis added]

28 Paragraph 15 of IAS 34 elaborates on this by stating:

> …It is unnecessary…for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period is more useful.

29 Furthermore, paragraph 16 states that an entity shall disclose ‘any event or transactions that are material to an understanding of the current interim period’. Paragraph 17 gives examples of the kind of disclosures required by paragraph 16.

30 Some are unsure whether disclosures about the fair value of financial instruments are required in IAS 34. The examples listed in paragraphs 16 and 17 of IAS 34 do not relate specifically to the fair value of financial instruments, except for the general requirement in paragraph 16(c) (‘the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence’).

31 The staff thinks IAS 34 is clear that entities are required to provide information about significant *changes* since the most recent annual report.

Staff recommendations

32 The staff recommends:

a clarifying the fair value hierarchy in IFRS 7 using Option 3 (paragraph 10c); that is, use the existing fair value hierarchy in IAS 39. Some entities are using this hierarchy in practice in designing disclosures to comply with IFRS 7.

b requiring quantitative disclosures to be presented in a tabular format.

c requiring a reconciliation from period to period for fair value measurements using significant unobservable inputs, with a narrative about movements between categories (levels).

d requiring for fair values that are disclosed but not recognised an indication of the category (level) of the hierarchy in which the instrument falls.

Questions for the Board

33 Does the Board agree to use the existing hierarchy in IAS 39 *Financial Instruments: Recognition and Measurement*, which represents what some entities are doing in practice to comply with IFRS 7's disclosure requirements and IAS 39's hierarchy?

34 Does the Board agree to provide more direction as to the form of quantitative disclosures with particular reference to a tabular format?

35 Does the Board agree to require a reconciliation from period to period for fair value measurements using significant unobservable inputs?

36 Does the Board agree to require a narrative description about the movements between categories (levels) of the hierarchy and why?

37 Does the Board agree to require, for fair values that are disclosed but not recognised, an indication of the category (level) of the hierarchy in which the instrument falls?

Appendix 1: SFAS 157 fair value hierarchy

22. To increase consistency and comparability in fair value measurements and related disclosures, the fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). In some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

23. The availability of inputs relevant to the asset or liability and the relative reliability of the inputs might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques. For example, a fair value measurement using a present value technique might fall within Level 2 or Level 3, depending on the inputs that are significant to the measurement in its entirety and the level in the fair value hierarchy within which those inputs fall.

Level 1 Inputs

24. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available, except as discussed in paragraphs 25 and 26.

25. If the reporting entity holds a large number of similar assets or liabilities (for example, debt securities) that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level measurement.

26. In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date. The reporting entity should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level measurement.

27. If the reporting entity holds a position in a single financial instrument (including a block) and the instrument is traded in an active market, the fair value of the position shall be measured within Level 1 as the product of the quoted price for the individual

instrument times the quantity held. The quoted price shall not be adjusted because of the size of the position relative to trading volume (blockage factor). The use of a blockage factor is prohibited, even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.[4]

Level 2 Inputs

28. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

    (a) Quoted prices for similar assets or liabilities in active markets

    (b) Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the asset or liability, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or in which little information is released publicly (for example, a principal-to-principal market)

    (c) Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)

    (d) Inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs).

29. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and/or location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

Level 3 Inputs

30. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions

[4] The guidance in this Statement applies for positions in financial instruments (including blocks) held by all entities, including broker-dealers and investment companies within the scope of the AICPA Audit and Accounting Guides for those industries.

about risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions.

Appendix 2: IAS 39 fair value hierarchy

Active market: quoted price

AG71 A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm's length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the balance sheet date in that instrument (ie without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.

AG72 The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (eg a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (eg because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

AG73 If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.

No active market: valuation technique

AG74 If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

AG75 The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

AG76 Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (ie without modification or repackaging) or based on any available observable market data. An entity obtains market data consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (ie the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

Appendix 3: SFAS 157 disclosure requirements

Disclosures

32. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements and for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period (except as otherwise specified) separately for each major category of assets and liabilities:

    (a) The fair value measurements at the reporting date

    (b) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

    (c) For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:[5]

        (1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)

        (2) Purchases, sales, issuances, and settlements (net)

        (3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)

    (d) The amount of the total gains or losses for the period in subparagraph (c)(1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)

    (e) In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques, if any, during the period.

33. For assets and liabilities that are measured at fair value on a nonrecurring basis in periods subsequent to initial recognition (for example, impaired assets), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements. To meet that objective, the reporting entity shall disclose the following information for each interim and annual

[5] For derivative assets and liabilities, the reconciliation disclosure required by paragraph 32(c) may be presented net.

period (except as otherwise specified) separately for each major category of assets and liabilities:

(a) The fair value measurements recorded during the period and the reasons for the measurements

(b) The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

(c) For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs

(d) In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes, if any, in the valuation technique(s) used to measure similar assets and/or liabilities in prior periods.

34. The quantitative disclosures required by this Statement shall be presented using a tabular format. (See Appendix A.)

35. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this Statement with the fair value information disclosed under other accounting pronouncements (for example, FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements (for example, inventories measured at market value under ARB 43, Chapter 4), if practicable.

Fair Value Disclosures

A33. This Statement requires disclosures about the fair value of assets and liabilities recognized in the statement of financial position in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, trading securities) or on a nonrecurring basis (for example, impaired assets). Quantitative disclosures using a tabular format are required in all periods (interim and annual). Qualitative (narrative) disclosures about the valuation techniques used to measure fair value are required in all annual periods. The disclosures required by paragraph 32(a)–(d) and paragraph 33(a) and (b) are illustrated below.

Assets Measured at Fair Value on a Recurring Basis

A34. For assets and liabilities measured at fair value on a recurring basis during the period, this Statement requires quantitative disclosures about the fair value measurements separately for each major category of assets and liabilities (paragraph 32(a) and (b)). For assets, that information might be presented as follows:

($ in 000s)		**Fair Value Measurements at Reporting Date Using**		
Description	**12/31/XX**	**Quoted Prices in Active Markets for Identical Assets**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**

		(Level 1)		
Trading securities	$115	$105	$10	
Available-for-sale securities	75	75		
Derivatives	60	25	15	$20
Venture capital investments	10			10
Total	$260	$205	$25	$30

(Note: For liabilities, a similar table should be presented.)

Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

A35. For assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the period, this Statement requires a reconciliation of the beginning and ending balances, separately for each major category of assets and liabilities, except for derivative assets and liabilities, which may be presented net (paragraph 32(c) and (d)). For assets, the reconciliation might be presented as follows:

($ in 000s)	**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**		
	Derivatives	**Venture Capital Investments**	**Total**
Beginning balance	$14	$11	$25
Total gains or losses (realized/unrealized)			
Included in earnings (or changes in net assets)	11	(3)	8
Included in other comprehensive income	4		4
Purchases, issuances, and settlements	(7)	2	(5)

Transfers in and/or out of Level 3	(2)	0	(2)
Ending balance	$20	$10	$30
The amount of total gains or losses for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$7	$2	$9

(Note: For liabilities, a similar table should be presented.)

Gains and losses (realized and unrealized) included in earnings (or changes in net assets) for the period (above) are reported in trading revenues and in other revenues as follows:

	Trading Revenues	Other Revenues
Total gains or losses included in earnings (or changes in net assets) for the period (above)	$11	$(3)
Change in unrealized gains or losses relating to assets still held at reporting date	$7	$2

Assets Measured at Fair Value on a Nonrecurring Basis

A36. For each major category of assets and liabilities measured at fair value on a nonrecurring basis during the period, this Statement requires disclosures about the fair value measurements (paragraph 33(a) and (b)). That information might be presented as follows:

($ in millions)		Fair Value Measurements Using			
Description	Year Ended 12/31/XX	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gains (Losses)
Long-lived assets held and used	$75		$75		$(25)
Goodwill	30			$30	(35)
Long-lived assets held for sale	26		26		(15)
					$(75)

In accordance with the provisions of Statement 144, long-lived assets held and used with a carrying amount of $100 million were written down to their fair value of $75 million, resulting in an impairment charge of $25 million, which was included in earnings for the period.

In accordance with the provisions of Statement 142, goodwill with a carrying amount of $65 million was written down to its implied fair value of $30 million, resulting in an impairment charge of $35 million, which was included in earnings for the period.

In accordance with the provisions of Statement 144, long-lived assets held for sale with a carrying amount of $35 million were written down to their fair value of $26 million, less cost to sell of $6 million (or $20 million), resulting in a loss of $15 million, which was included in earnings for the period.

Appendix 4: IAS 34 interim disclosures

Content of an interim financial report

…

6 In the interest of timeliness and cost considerations and to avoid repetition of information previously reported, an entity may be required to or may elect to provide less information at interim dates as compared with its annual financial statements. This Standard defines the minimum content of an interim financial report as including condensed financial statements and selected explanatory notes. The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

7 Nothing in this Standard is intended to prohibit or discourage an entity from publishing a complete set of financial statements (as described in IAS 1) in its interim financial report, rather than condensed financial statements and selected explanatory notes. Nor does this Standard prohibit or discourage an entity from including in condensed interim financial statements more than the minimum line items or selected explanatory notes as set out in this Standard. The recognition and measurement guidance in this Standard applies also to complete financial statements for an interim period, and such statements would include all of the disclosures required by this Standard (particularly the selected note disclosures in paragraph 16) as well as those required by other Standards.

…

Selected explanatory notes

15 A user of an entity's interim financial report will also have access to the most recent annual financial report of that entity. It is unnecessary, therefore, for the notes to an interim financial report to provide relatively insignificant updates to the information that was already reported in the notes in the most recent annual report. At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period is more useful.

16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period:

(a) a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements or, if those policies or methods have been changed, a description of the nature and effect of the change;

(b) explanatory comments about the seasonality or cyclicality of interim operations;

(c) the nature and amount of items affecting assets, liabilities, equity, net income, or cash flows that are unusual because of their nature, size, or incidence;

(d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period;

(e) issuances, repurchases, and repayments of debt and equity securities;

(f) dividends paid (aggregate or per share) separately for ordinary shares and other shares;

(g) the following segment information (disclosure of segment information is required in an entity's interim financial report only if IFRS 8 *Operating Segments* requires that entity to disclose segment information in its annual financial statements):

(i) revenues from external customers, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(ii) intersegment revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker or otherwise regularly provided to the chief operating decision maker;

(iii) a measure of segment profit or loss;

(iv) total assets for which there has been a material change from the amount disclosed in the last annual financial statements;

(v) a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss;

(vi) a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation;

(h) material events subsequent to the end of the interim period that have not been reflected in the financial statements for the interim period;

(i) the effect of changes in the composition of the entity during the interim period, including business combinations, obtaining or losing control of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required by IFRS 3 *Business Combinations*; and

(j) changes in contingent liabilities or contingent assets since the end of the last annual reporting period.

17 Examples of the kinds of disclosures that are required by paragraph 16 are set out below. Individual Standards and Interpretations provide guidance regarding disclosures for many of these items:

(a) the write-down of inventories to net realisable value and the reversal of such a write-down;

(b) recognition of a loss from the impairment of property, plant and equipment, intangible assets, or other assets, and the reversal of such an impairment loss;

(c) the reversal of any provisions for the costs of restructuring;

(d) acquisitions and disposals of items of property, plant and equipment;

(e) commitments for the purchase of property, plant and equipment;

(f) litigation settlements;

(g) corrections of prior period errors;

(h) [deleted]

(i) any loan default or breach of a loan agreement that has not been remedied on or before the end of the reporting period; and

(j) related party transactions.