Project **Fair Value Measurement**

Topic **Disclosures**

Purpose of this paper

1. On 9 April the FASB issued:

   (a) FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*

   (b) FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*

2. This paper:

   (a) summarises the amendments FSP 157-4, FSP 107-1 and APB 28-1 makes to the **interim disclosure** requirements for fair value measurements and compares them with the Board's tentative equivalent disclosure requirements

   (b) summarises the amendments FSP 157-4 makes to the requirements to make disclosures by **major category** in SFAS 157 and compares them with the Board's tentative equivalent disclosure requirement

   (c) provides the staff analysis

   (d) asks whether the Board agrees with the staff recommendation

Background

3. The Board discussed interim disclosures for the fair value measurement ED at its January 2009 meeting. Since this meeting, the FASB has made further amendments to its interim disclosures for fair value measurements. Therefore, SFAS 157 *Fair Value Measurements* (which forms the starting point of our ED) now requires more disclosures of fair value measurements for interim reporting periods. In light of these new developments, the staff thinks it is appropriate that the Board discuss the latest FASB amendments to fair value disclosures and whether it wants to incorporate any of this guidance in the ED on fair value measurements.

4. At its February 2009 meeting, the Board discussed whether some additional disclosure should be required in interim financial reports, particularly in current market conditions. The Board tentatively decided to emphasise the disclosure principles in IAS 34 *Interim Financial Reporting* and to consider adding further guidance to illustrate how to apply these principles.

5. The amendments to fair value disclosure requirements in the above FSPs have mainly focussed on disclosure requirements for interim financial reports.

6. SFAS 157 requires disclosures about the fair value of assets and liabilities recognised in the statement of financial position.

7. SFAS 107 *Disclosures about Fair Value of Financial Instruments* requires disclosures about the fair value of financial instruments recognised and not recognised on the statement of financial position.

8. APB Opinion No. 28 *Interim Financial Reporting* requires certain disclosures in summarised financial information in interim periods.

9. The FSPs disclosure amendments deal with two requirements:

   (a) it requires fair value disclosures for interim periods.

   (b) it requires fair value disclosures of financial instruments by major security type.

10. The staff analysis deals with these separately.

Summary of amendments to fair value disclosures for *interim reporting periods*

11. FSP FAS 107-1 and APB 28-1 applies to all financial instruments within the scope of SFAS 107 held by trading companies, as defined by APB 28.

12. FSP 157-4 amends interim disclosures for assets and liabilities measured at fair value and recognised in the statement of financial position. FSP 107-1 and APB 28-1 amend interim disclosures for financial instruments, recognised and not recognised in the statement of financial position.

Amendments requiring disclosures of fair value for financial instruments in interim periods, recognised and not recognised in the statement of financial position

Amendments that FSP107-1 and APB 28-1 make to SFAS 107-1 and APB 28	**The IASB's tentative equivalent**
FSP 107-1 amends SFAS 107 and APB 28 to require disclosures about fair value of financial instruments for interim reporting periods. Paragraph 7 of SFAS 107 (not amended) requires disclosures about fair value for all financial instruments, whether recognised or not recognised in the statement of financial position. Paragraph 10 requires disclosures of and the techniques and assumptions used to measure fair value as well as any changes in these methods and assumptions, during the period.	If an entity's interim financial report is described as complying with IFRSs, IAS 34 requires it to present either: (a) full financial statements, or (b) condensed financial statements with selected explanatory notes. The required disclosures do not include the fair value of assets and liabilities not carried at fair value. Therefore, an entity would apply the tentative disclosure requirements in the [draft] IFRS on fair value measurement for annual periods and if applicable it would apply the principle in IAS 34 for interim reporting periods. That is, that an entity disclose information that will enable users to understand any significant changes in circumstances that have taken place since the last reporting period.
APB 28 requires public companies to provide disclosures of fair values.	IAS 34 does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period. However, governments, securities regulators, stock exchanges and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish interim financial reports.

Amendments requiring disclosures of all assets and liabilities measured at fair value recognised in the statement of financial position

Amendments FSP 157-4 makes to SFAS 157	**The IASB's tentative equivalent**
Entities are required to disclose **in interim and annual periods** the inputs and valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques and related inputs, if any, during the period (see paragraph 32 of SFAS 157). (*previously this disclosure requirement applied only to annual periods*).	The equivalent disclosure requirement is broadly the same, except that it is **only required for annual periods**. However, paragraph 15 of IAS 34 states that 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 transaction 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.

Staff analysis

13. In light of the amendments the FASB made in the FSPs, the staff thinks that the Board has three options. The staff have summarised its analysis in the appendix to this paper.

Option 1:

14. The Board can proceed as decided at the February 2009 meeting. That is, to emphasise the disclosure principle in IAS 34, but not introduce more specific requirements into IAS 34.

15. This approach may limit users' ability to understand changes in fair values in interim periods. It may also mean that interim reports prepared using IFRSs disclose less information than US GAAP interim reports.

16. However, this approach does enhance the principle in IAS 34 and require entities to apply judgment to provide users of the interim report with enough

information to enhance their ability to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.

Option 2:

17. The Board could amend IAS 34 to require more specific fair value disclosures. If the Board decides to do this it will require fair value disclosures for interim periods if these disclosures are also required for annual periods for that particular class of asset or liability.

18. The Board could decide to add more specific disclosures for **all** assets and liabilities measured at fair value or only for **financial instruments** measured at fair value.

19. Such amendments might not necessarily be as extensive as the interim disclosures required by SFAS 157, nor as extensive as the disclosures that would be required annually applying the exposure draft on fair value measurement. For example, such specific fair value disclosures could include:

    (a) the fair values, analysed by levels 1,2,3

    (b) changes in methods and in valuation techniques

    (c) significant transfers between levels for assets and liabilities still held

    (d) gains and losses on level 3 assets and liabilities still held

20. The following might not be included because, arguably, they go beyond the spirit of the existing requirements in IAS 34:

    (a) changes in assumptions [arguably, the disclosure principle in IAS 34 would be require disclosure of some changes in assumptions if they are sufficiently significant]

    (b) level 3 roll forward

    (c) level 3 gains and losses

    (d) sensitivity analysis on assumptions

21. Arguably, if an entity is required to disclose the fair value of some assets or liabilities annually, interim disclosure of fair values for those assets and liabilities is merely an extension of the requirement in IAS 34 to provide at least a condensed statement of financial position. However, providing the full suite

of fair value disclosures would, arguably, be more than just a simple extension of that requirement.

Option 3:

22. The Board could amend IAS 34 to require the same fair value disclosures for interim periods that it proposes to require annually. Similar to option 2, if the Board decides to do this it will not require fair value disclosures for interim periods that are not required for annual periods for a particular class of asset or liability.

23. The Board could decide to do this for **all** assets and liabilities measured at fair value or only for **financial instruments** measured at fair value.

24. Paragraph 25 of IFRS 7 *Financial Instruments: Disclosures* require entities to disclose the fair value of each class of financial instrument in a way to make it comparable with its carrying amount. Paragraph 27 of IFRS 7 requires disclosures of the methods and assumptions applied in determining the fair values and any changes in these methods or assumptions.

25. Therefore, if the Board decides on this option, the Board will have to require a similar disclosure in interim reports as that in paragraphs 25 and 27 of IFRS 7.

26. The staff think that the benefit of providing such disclosures for financial assets and financial liabilities is more likely to outweigh the cost, given the greater interest in financial instruments since the credit crisis began. However, the cost of providing such disclosures might outweigh the benefit for some other assets and liabilities. Moreover, the disclosure requirements introduced by FSP 107-1 and APB28-1 apply only to financial instruments. Therefore, the staff recommends that the Board should limit any additional specific disclosure requirements in interim financial reports to financial instruments. If information about the fair value of non-financial asset or liability is sufficiently significant, it will fall under the disclosure principle currently in IAS 34.

27. The staff will provide the draft wording for this in the ballot draft of the [draft] exposure draft for fair value measurements, depending on what the Board decides.

28. Option 3 would provide more information to users than option 1 or 2 but is, arguably, inconsistent with the general approach in IAS 34.

29. In the staff's view, if the Board adopts options 2 or 3, it is not necessary to limit the requirement to publicly traded companies. In practice, it is likely that most entities applying IAS 34 have publicly traded debt or equity securities.

Staff recommendation and question

Question 1 – Financial instruments measured at fair value

The staff recommends that the fair value disclosures in the [draft] IFRS *Fair Value Measurement*, be required for financial instruments in **both interim and annual** periods. Does the Board agree? If not, why not and how does the Board want to proceed with disclosures for interim financial reports in the ED on fair value measurement?

Staff recommendation and question

Question 2 – Financial instruments not measured at fair value

The staff recommends that the fair value disclosures in paragraphs 25 and 27 of IFRS 7 be required for financial instruments in **interim** periods in IAS 34. Does the Board agree? If not, why not and how does the Board want to proceed with disclosures for interim financial reports in the ED for financial instruments not measured at fair value?

Staff recommendation and question

Question 3 – Non-financial assets and liabilities measured at fair value

The staff recommends the Board does not introduce specific fair value disclosure requirements for interim periods for non-financial assets and liabilities measured at fair value.. Does the Board agree? If not, why not and how does the Board want to proceed with disclosures for interim financial reports in the ED for non-financial assets and liabilities measured at fair value?

Staff recommendation and question

Question 4 – Non-financial assets and liabilities not measured at fair value

The staff recommends the Board does not introduce specific fair value disclosure requirements for interim periods for non-financial assets and liabilities not measured at fair value.. Does the Board agree? If not, why not and how does the Board want to proceed with disclosures for interim financial reports in the ED for non-financial assets and liabilities not measured at fair value?

30. If the Board decides to require specific fair value disclosures for interim periods, then:

Staff recommendation and question
Question 5 – Timing of the amendments to require specific interim disclosures for fair value
The staff recommends that the Board introduce the proposed specific fair value disclosures for interim periods in the ED for fair value measurements. The staff also recommends that the Board do not take any action to introduce these requirements more rapidly. Does the Board agree? If not, why not and how does the board want to proceed with an amendment to IAS 34 to require specific fair value disclosures as decided in question 1 to 4 above?

Summary of the amendment to *major categories* of asset and liability for fair value disclosures

31. FSP 157-4 applies to all assets and liabilities within the scope of US accounting pronouncements that require or permit fair value measurements.

Amendments FSP 157-4 makes to SFAS 157	**The IASB's tentative equivalent**
Entities are required to disclose fair value information by **major category** of asset and liability. This FSP defines *major category* for equity securities and debt securities to be major security types as described in paragraph 19 of SFAS 115 *Accounting for Certain Investments in Debt and Equity Securities* (see paragraph 32 and 33 of SFAS 157). Therefore, in complying with this requirement entities will include in their disclosure the following major security types (though additional types may be necessary): (a) equity securities (segregated by industry type, company size or investment objective) (b) debt security issued by the U.S. Treasury and other U.S. government corporations and agencies (c) debt securities issued by states of	Entities are required to provide fair value disclosures for **each class** of assets or and liability. A class is described in IFRSs as a grouping of assets or liabilities of a similar nature and use (IAS 16.37, IAS 36.127 and IAS 38.119). A class of financial instrument is described in paragraph 6 of IFRS 7 as a grouping of financial instruments that is appropriate to the nature of the information disclosed and that takes into account the characteristics of those financial instruments. A class is generally at a level lower than a major category (eg 'equity investments' or 'land and buildings' rather than 'available for sale instruments' and 'property, plant and equipment').

the U.S. and political subdivisions of the states (d) debt securities issued by foreign governments (e) corporate debt securities (f) residential mortgage-backed securities (g) commercial mortgage-backed securities (h) collateralised debt obligations (i) other debt obligations	

Staff analysis

32. At its January 2009 meeting the Board decided that entities are required to make fair value disclosures for each class of assets or and liability. The Board did not specify what makes up each class. Entities are required to make fair value disclosures with the same granularity as required by each IFRS requiring the asset or liability to be measured at fair value.

33. IFRS 7 does not prescribe the classes specified for financial instruments. Paragraph 6 of IFRS 7 requires that entities group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

34. FSP 107-1 requires fair value disclosures for financial instruments by major security type in accordance with SFAS 107. These *major security types* seem specific to US jurisdictions and will not necessarily be appropriate for all entities applying IFRSs (see the table in paragraph 31).

35. One respondent to the Board's *Request for Views* (see Agenda Papers 16 of the April 2009 Board meeting) commented on this amendment. This respondent noted that they are not supportive of ad hoc additions to disclosure requirements and rather support the establishment of a disclosure framework to establish principles to determine which disclosures are decision useful, this framework would then be used to review existing and new disclosures.

Staff recommendation and question
Question 5 The staff recommends that the Board reaffirm its decision to require fair value disclosures for each class of financial asset or financial liability based on judgment and not to require fair value disclosures for financial instruments by *major type of security* as described in SFAS 115. Does the Board agree? If not, why not and how would the Board want *classes* to be defined?

Appendix – Fair value disclosures for interim reporting periods

	Financial instruments measured at fair value	**Financial instruments not measured at fair value**	**Non-financial assets and liabilities measured at fair value**	**Non-financial assets and liabilities not measured at fair value**
FSP 157-4	Inputs and valuation techniques used to measure fair value and discussion of changes in valuation technique	n/a	Inputs and valuation techniques used to measure fair value and discussion of changes in valuation technique	n/a
FSP 107-1 and APB 28-1 (Applicable to **annual and interim** financial reports of public entities, optional for non-public entities)	• Disclose the fair value • Disclose significant assumptions and valuation techniques used to measure fair value and discussion of changes in valuation technique	• Disclose the fair value • Disclose significant assumptions and valuation techniques used to measure fair value and discussion of changes in valuation technique	n/a	n/a
Board's tentative fair value disclosure requirements	Paragraph 15 of IAS 34 Interim Financial Reporting states that 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.			

	Financial instruments measured at fair value	**Financial instruments not measured at fair value**	**Non-financial assets and liabilities measured at fair value**	**Non-financial assets and liabilities not measured at fair value**
Option 1	Apply the principle in IAS 34			
Option 2	Apply the principle in IAS 34 with some more specific fair value disclosures, but not all those that would be required annually			
Option 3	Apply the fair value disclosures required for annual periods to interim periods			
Staff recommendation	Option 3	Option 3, that is: • Disclose the fair value • Disclose significant assumptions and valuation techniques used to measure fair value and discussion of changes in valuation technique	Option 1	Option 1
Question for the Board	Question 1	Question 2	Question 3	Question 4