

Introduction

- 1. Under the Board's approach, at initial recognition all financial assets and financial liabilities are classified on the basis of:
 - (a) the entity's business model for managing its instruments; and
 - (b) the contractual cash flow characteristics of the instrument.
- A financial asset or liability is subsequently measured at amortized cost only if the objective of the entity's business model is to hold the instruments to collect (or pay) the contractual cash flows <u>and</u> the instrument's contractual cash flows represent payments of principal and interest.
- 3. All other instruments are subsequently measured at fair value (except particular financial liabilities, which are subsequently measured at adjusted fair value).

Purpose of this paper

- 4. This paper discusses whether an entity should be required to present on the face of the statement of comprehensive income the total gains or losses for the period related to fair value measurements (including adjusted fair value) in Level 3 of the hierarchy.
- 5. In other words, this paper asks the Board whether the total gains or losses that currently are required to be <u>disclosed</u> as part of the Level 3 reconciliation should be presented on the face of the statement of comprehensive income. That reconciliation is described in paragraph 27B(c) of IFRS 7 *Financial Instruments:*

This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

Decisions made by the Board are reported in IASB Update.

Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

Disclosures. For board members' convenience the relevant portions of paragraph 27 of IFRS 7 are reproduced below.

- 6. The amounts described in this paper could be presented in brackets alongside each profit or loss line item that includes fair value measurements that fall in Level 3. A similar presentation could be required for equity investments that are measured at fair value with changes in fair value recognized in other comprehensive income.
- 7. This paper does <u>not</u> address
 - (a) <u>other possible ways</u> to disaggregate fair value gains or losses in the statement of comprehensive income; or
 - (b) instruments measured at fair value through <u>OCI</u>.

Requirements in IFRS 7

8. IFRS 7 was amended in March 2009 to require enhanced disclosures about fair value measurements. Those amendments were mandatorily effective for annual periods beginning on or after 1 January 2009. Among those enhanced disclosures, paragraph 27B was added (reproduced here in part with the relevant disclosure emphasized in bold):

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- (c) **for fair value measurements in Level 3 of the fair value hierarchy**, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:
 - (i) total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented);
 - (ii) total gains or losses recognised in other comprehensive income;
 - (iii) purchases, sales, issues and settlements (each type of movement disclosed separately); and
 - (iv) transfers into or out of Level 3 (eg transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3

(d) the amount of total gains or losses for the period in (c)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).

Feedback received

- 9. Some respondents to the ED and participants in the outreach programme opposed measuring financial instruments at fair value through profit or loss if those fair value measurements are unreliable (ie there is significant measurement uncertainty). Specifically, those respondents focused on instruments that are either not actively traded, have insufficient market depth, or rely on valuation models using unobservable uncertainty. However, since the Board's approach does not determine classification on the basis of the reliability of fair value measurements, these constituents believe that such a presentation requirement is essential to highlight measurement uncertainty.
- 10. Other constituents, including some users, think presenting on the face of the statement of comprehensive income total gains or losses for fair value measurements in Level 3 would provide decision-useful information about how much of the total fair value gain or loss for the period was attributable to fair value measurements that are subject to significant measurement uncertainty.
- 11. Others were indifferent about whether this information is included in the notes or on the face of the statement of comprehensive income.

Staff analysis and recommendation

- 12. At this stage, we do not recommend requiring this information on the face of the statement of comprehensive income.
- 13. We believe that the requests from some constituents for more prominent display of fair value gains and losses that are subject to significant measurement uncertainty would emphasize the "quality" of reported gains and losses.

IASB Staff paper

- 14. However, the staff would prefer to discuss whether and, if so how, such presentation should be made with more constituents, especially additional users.
- 15. "What" to require more prominent display of is not a simple question. For example, should only gains and losses in Level 3 for instruments that are held at the end of the reporting period be required? Or should all reported Level 3 gains and losses recognised in the period be separately presented? Furthermore, should a net gain or loss be presented—or should gains be separately presented from losses? Finally, should this requirement apply to **all** financial instruments or just a subset (for example, some might want to **exclude** derivatives and other instruments that are held for trading)?
- 16. "How" to present this information should also be considered. In paragraph 6 we noted that a figure—or figures—could be presented in brackets for each line item in the statement of comprehensive income. Such an approach would not change the current line item structure of the statement. Alternatively, the figure could be broken out into a new, separate line item.
- 17. The **disclosure** requirement referred to earlier in this paper was added to IFRS 7 in March and thus is relatively new to IFRS constituents. We note that the fair value measurement (FVM) project team has received questions about how to apply the disclosure in particular circumstances. In addition, we note that the Board has proposed fair value measurement disclosures as part of the FVM exposure draft (ED).
- On balance, we believe that the Board should consider a presentation requirement that emphasizes the fair value gains and losses that are subject to significant measurement uncertainty.
- 19. However, we believe that:
 - (a) the staff should discuss this issue further, with users (including regulators) in particular, to understand better the value of such presentation, what should be presented, and how it should be presented; and
 - (b) the Board should consider the questions on the existing IFRS 7 disclosures and comments on the disclosure proposals in the FVM ED, alongside this issue of enhanced presentation.

- 20. Furthermore, the Board has considered the topic of disaggregating fair value gains or losses in other projects. For example, at the joint meeting in July, the boards discussed in the Financial Instruments with Characteristics of Equity project an approach for disaggregating fair value changes of financial liabilities (labelled the "cost of capital" approach). The Board might want to consider the presentation requirement discussed in this paper in the context of similar issues in other projects
- 21. In summary, if the Board wishes to explore this issue further, we think it could be considered as part of the Board's project of fair value measurement. This would allow the staff to further analyze the proposal, discuss it with additional constituents (including users), and better understand the practice problems related to the existing disclosure in IFRS 7.
- 22. Moreover, this topic could be considered as part of the convergence process when the IASB and FASB work to reconcile any differences in their classification and measurement approaches.
- 23. However, if the Board does not agree with the staff recommendation and decides to require this information on the face of the statement of comprehensive income, we suggest that the net fair value gain or loss for financial instruments held at the end of the reporting period be presented in brackets alongside the relevant profit or loss line item.

Question 1 – Presentation of Level 3 fair value gains or losses

Does the Board agree with the staff recommendation that the total gains or losses for the period for fair value measurements in Level 3 of the fair value hierarchy should <u>not</u> be required on the face of the statement of comprehensive income as part of the forthcoming IFRS on classification and measurement?

If not, what would you propose instead and why?