

Post-implementation Review of IFRS 13 *Fair Value Measurement*

Feedback received

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Agenda Paper 5

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- Purpose of this session
- Introduction and project status
- Questions for ASAF members
- Feedback received:
 - Disclosures
 - Other topics:
 - Unit of account
 - Highest and best use
 - Application of judgements
 - Fair value measurement of biological assets and unquoted equity instruments
 - Effects and convergence

Purpose of the session

- Share **summary*** feedback from the Request for Information (RFI) on the Post-implementation Review (PIR) of IFRS 13 *Fair Value Measurement*
- Obtain your comments on the feedback received
- Seek your advice on the Board actions

* We will send you December Board papers with detailed feedback as soon as ready – we expect this to be a couple of weeks before ASAF meeting.

Thank you first

- We received 18 responses to the RFI from national or regional standard-setters.
- A large majority of the standard-setters responding completed their own outreach and research which was summarised in their responses (and which sometimes included feedback from users).
- We held informal discussions with some of the standard-setters who did not submit a formal response.

Thank you!

Questions for ASAF members

Disclosures

- Q1a** Do you have any comments on the overall feedback we received on fair value measurement disclosures (slides 17-22)?
- Q1b** What action, if any, do you think the Board should consider taking and why?
- Q1c** Do you think any of the suggestions relating to the disclosures would bring significant benefits to the users of financial statements and why (slides 23-25)?

Other RFI topics

- Q2a** Do you have any comments on the overall feedback we received on other topics in the RFI (slides 27-35):
- unit of account;
 - highest and best use;
 - application of judgements;
 - fair value measurement of biological assets and unquoted equity instruments; and
 - effects, convergence and other matters?
- Q2b** What action, if any, do you think the Board should consider taking and why?

- PIRs serve an important role, helping the Board assess whether a Standard is:
 - working as intended; and
 - providing useful information to users of financial statements.
- The Board sought feedback through a RFI.
- The questions in the RFI focused on obtaining evidence, and not views.
- The staff are processing the feedback and seeking ASAF input prior to Board discussions.
- The Board can take several steps following a PIR, not necessarily involving standard-setting.

Status of the PIR of IFRS 13

Consultation



Research conclusion



When is the guidance in IFRS 13 on how to measure fair value used?

IFRS 13 applies when another IFRS Standard...

requires fair value measurement for some or all items within its scope, with or without IFRS 13 disclosures

permits fair value measurement, with IFRS 13 disclosures required

requires fair value information for items measured at cost

IFRS 3 *Business Combinations**

IFRS 9 *Financial Instruments***

IAS 36 *Impairment**, **

IAS 19 *Employee Benefits**, **

IAS 41 *Agriculture*

IFRS 5 *Assets Held for Sale***

IAS 16 *Property, Plant and Equipment*

IAS 38 *Intangible Assets*

IAS 40 *Investment Property*

IFRS 9 *Financial Instruments*

IAS 40 *Investment Property*

* IFRS 13 disclosures are not required.

** Applied to some items in the scope of the Standard or to items in specific circumstances.

Particular focus on usefulness of disclosures

Specific measurement aspects:

The unit of account and fair value of quoted investments: PxQ

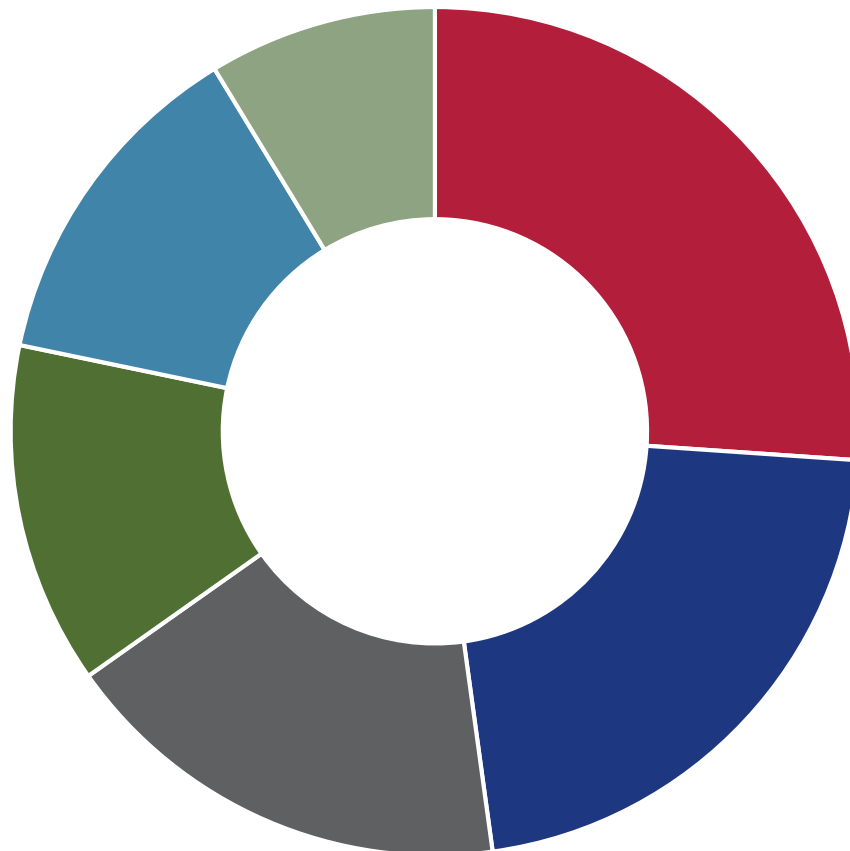
Application of judgements

Application of highest and best use of non-financial assets

Also, researched the challenges with measuring the fair value of biological assets and unquoted equities

RFI consultation and feedback – investor outreach

- Staff held 14 meetings with 20 investor organisations and representative bodies:



■ Representative Body (6)

■ Investment bank (5)

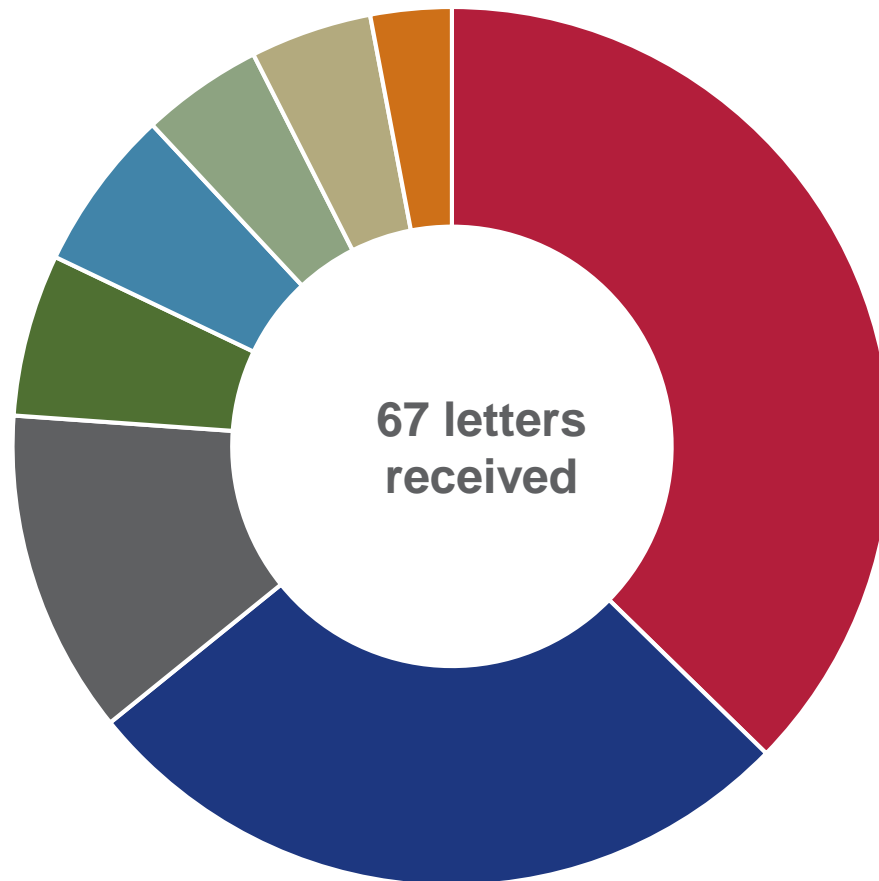
■ Investment research (4)

■ Asset management (3)

■ Valuation specialist (3)

■ Ratings agency (2)

RFI consultation and feedback - comment letter breakdown



- Preparer (25)
- Standard-setter (18)
- Auditor (8)
- Professional accounting body (4)
- User/Investor (4)
- Academic (3)
- Valuation specialist (3)

Feedback **consistent** with initial assessment prior to the RFI publication. There are persistent differences in views between preparers and users on the unit of account issue (often referred to as **PxQ**) and some **disclosures**.

Relatively stable economic environment along with regulatory developments which may indicate there is **currently less interest** in Level 3 disclosures and overall fair value measurement.

What did we find out about use of fair value in practice*

- Fair value measurement mostly used in accounting for financial instruments and in business combinations; as well as in impairment testing.
- Little use of fair value option for property, plant and equipment and intangibles.
- Regional trends in accounting method for investment properties with some areas, for example, Japan and South America tending to choose cost method.
- Since changes to IAS 41 took effect in 2016, bearer plants are typically carried at cost, reducing use of fair value measurement for biological assets.

* These are anecdotal findings based on discussions and examples of financial statements.

What did we find out about fair value in practice* - fair value hierarchy

15

- Investment property and biological assets measured at fair value tend to be measured at Level 3 (L3) of the fair value hierarchy.
- Financial instruments—a significant decrease of proportion of L3 measurements compared to a decade ago (attributed to the global financial crisis and changes to regulatory requirements making L3 instruments unattractive).
- Smaller, simpler banks may have nothing in L3.
- However, there may have been an overall increase in private equity investments—L3 measurements.

* These are anecdotal findings based on discussions and examples of financial statements.

Specific feedback on disclosures

- Fair value measurement **hierarchy** is the single most useful disclosure.
 - First step: identify L3 assets as proportion of total assets.
 - Several investors do not look at L3 disclosures if L3 is an insignificant part of total, unless they are aware of assets in stress.
- Description of **valuation processes, techniques** and disclosure of **significant unobservable inputs** very useful.
 - Disclosures presented in a table cross-referenced to measurements most useful.
 - Help understand the approach and build confidence in model used.
- Also useful:
 - Information about **transfers between levels**, in particular between L2 and L3; useful to track instruments moving between levels; and
 - Effects of **L3 measurements on P&L**; interested in relationship to overall profit or loss.

Investor feedback - mixed views on usefulness

Most investors thought the **reconciliation of changes in Level 3 measurements** was useful but some did not.

Useful because the volume of changes in the period enables users to **understand the significance** of level 3 measurements to business model; and because it imposes discipline and gives investors **confidence**.

Not useful because only a few items are **relevant** and used in analysis (P&L impact and transfers); and the grouping and description of changes can be **hard to understand** and analyse.

Investor feedback - mixed views on usefulness, continued

Most investors thought the analysis of **sensitivity of Level 3 measurements** to reasonably possible changes in significant unobservable inputs was useful but there are issues with practice.

Quantitative analysis is useful because it helps to understand the **room for manoeuvre** and which point did management choose. Most useful when **disaggregated** to instruments with similar risks –which may not be practicable.

Evidence of **misunderstanding** of its purpose—insight in **uncertainty at measurement date**, and not sensitivity to future changes. **Narrative** sensitivity disclosure generally **not useful**.

Feedback from others - usefulness of disclosures

- Agreed with investors' feedback on most useful disclosures.
- Many stakeholders, preparers in particular, thought **reconciliation of changes in Level 3 fair value measurements** and **analysis of sensitivity to significant unobservable inputs were not useful**, for the following reasons:
 - not used for internal management purposes;
 - marginal benefits do not justify significant costs of preparing these disclosures; and
 - usefulness limited by aggregation.

Investor feedback - factors affecting usefulness

21

Aggregation of dissimilar instruments or instruments subject to different risks makes disclosures about them hard to use.

Significant proportion of disclosures in **other** category.

Differences in **level of detail** provided hinders comparisons, for example, on valuation techniques used.

Presentation - fair value disclosures dispersed across notes, and not clearly linked, makes them hard to use.

Tabular presentation most useful –for example for significant unobservable inputs and sensitivity analysis.

Materiality –if L3 instruments are a small proportion of an entity's balance sheet, L3 disclosures are just clutter.

Some information is **unavoidably generic** – for example, when describing a valuation technique, but still useful.

Feedback from others - factors affecting usefulness

22

Similar feedback as from investors, with focus:

Comparability limited by differences in methodologies, especially for significant unobservable inputs and quantitative sensitivity analysis

Generic disclosures can be useful but practice may **not** be **relevant**

Useful **disaggregation** often impractical

Drafting of disclosure requirements in IFRS 13 promotes **checklist approach** and disclosure of **immaterial** information

Fair value disclosures - suggestions from investors

23

- **Expand** disclosures for **L1 and L2 assets** to include (un)realised gains/losses.
- **Valuation techniques and inputs:**
 - Include **weighted averages** in the disclosure of ranges of unobservable inputs and/or remove outliers; and
 - Promote consistency of disclosure by providing **examples** of information expected to be disclosed in relation to valuation techniques and significant unobservable inputs.
- Some suggested **removing** the requirement for **reconciliation of L3 instruments**, only requiring information on P&L effect and transfers between levels. Other investors strongly opposed removing this disclosure (or any other).
- Address **aggregation** issues.

Fair value disclosures – suggestions from investors, continued

24

Sensitivity analysis - varying suggestions

- rename as uncertainty analysis to make purpose clearer;
- remove requirement for narrative and require numerical sensitivity for non-financial instruments;
- reflect correlations between inputs;
- remove requirement for numerical analysis altogether.

Suggestions outside the scope of IFRS 13

- Expand the scope of IFRS 13 disclosure requirements
- Require entity-specific information:
 - intention about timing of liquidation of assets measured at fair value;
 - difference between highest and best use and value in use, and intentions on crystallising highest and best use.

Fair value disclosures – suggestions* from other stakeholders

- Many expect that the **Materiality Practice Statement** and the **Principles of Disclosures** project will help address some of the issues.
- Somewhat consistent with investor’s feedback, with the following differences:
 - Many preparers, particularly in the banking industry, would like to see requirements for reconciliation and quantitative sensitivity analysis removed – others were suggesting to promote consistency and appropriate disaggregation of these disclosures.
 - Less interest in expanding disclosures for L1 and L2 instruments, except by some securities regulators.

Specific feedback on other topics

Unit of account and fair value measurements - current practice

- The PxQ issue is not relevant to most respondents.
- Rarely relevant for others, except in relation to investments by investment entities and for venture capital organisations.
- When relevant, stakeholders report material differences between PxQ and valuation using a method such as discounted cash flows.
- Regulators note the financial statements do not make it clear whether PxQ was applied and, if adjusted, how.

Unit of account and fair value measurement - views on accounting

28

Investors

- Majority of investors would want the measurement to be based on PxQ because it is seen as unbiased and some investors think control premiums often do not exist in practice anyway.
- Some investors would permit the measurement to depart from PxQ, but would want explanation of any difference.

Other stakeholders

- Large majority, in particular preparers, want the measurement to be based on the unit of account and reflect the value of control.
- Some stakeholders asked for blockage discounts to be reflected.

- Little feedback on HBU from investors apart from general support for the concept.
- Many other stakeholders find the application of the HBU concept challenging, although in practice current use is usually the same as the HBU.
- Main challenges:
 - judgements surrounding ‘legally permissible’ criteria;
 - amount of evidence required; and
 - general understanding of the concept.

- Little investor input, some questions on classification consistency.
- Assessment is challenging for most other stakeholders. When not challenging, mostly due to internal or industry level guidance.
- Some of the challenges:
 - how much is sufficient frequency and volume;
 - how recent is ‘recent’ and how relevant ‘relevant’; and
 - how wide bid/ask spread most of those asking the Board to provide additional guidance or examples.
- Most respondents who found it challenging asked the Board to provide additional guidance or examples.

Application of judgements - significant unobservable inputs

- Assessment challenging for most although slightly less than assessment of active market.
- When not challenging, mostly either because specific methods are adopted (such as using BVAL score) or L3 not relevant.
- Main challenges:
 - assessment of what is ‘significant’, eg quantitative vs qualitative assessment, assessment at point in time or over time;
 - practical issues with use of third-party prices or brokers; and
 - treatment of adjustments to observable inputs.

Fair value measurement of biological assets

32

- Relevant to some, and challenging for large majority of those respondents.
- However, valuation experts report appropriate valuation techniques by types of biological assets and say ongoing application usually not challenging.
- Main challenges:
 - all measurement aspects challenging for some, including: quality, quantity, yield and stage of growth of biological assets;
 - measurement of immature assets particularly challenging, including point of recognition;
 - reliability assessment; and
 - a lot of divergence in current practice.

- Many suggested that the Board should develop illustrative examples and/or education materials.
- Some suggested that the Board should provide guidance on reliability assessment.
- Some suggested the inclusion of some assets in the scope of IAS 2 *Inventories*.
- A few expect divergence to decline as valuation practice develops.
- A few suggested engagement with valuation community to help promote consistency.

FVM of unquoted equities

- Most respondents to this question said they were familiar with education material on unquoted equities
- Most of those respondents suggested additional guidance including:
 - dealing with significant differences in results of valuation methods;
 - application of premiums and discounts;
 - problems with valuation of early-stage equities;
 - details of cost of capital calculations; and
 - dealing with multiple securities.
- Some respondents suggested referring to widely used industry valuation guides, such as International Private Equity and Venture Capital Valuation Guidelines.

- Some respondents discussed the effect of IFRS 13 on users' ability to assess future cash flows. Most of those thought it improved users' ability to assess future cash flows.
- Many discussed comparability, with large majority saying IFRS 13 has improved comparability.
- Split experience of costs of compliance.
- A large majority said convergence with US GAAP was important.

What is happening in the US

- Standards substantially converged.
- 2015 Exposure Draft with proposals for public companies to:
 - Remove:
 - the amounts of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; and
 - the policy for the timing of transfers between levels, valuation policies and procedures for Level 3 fair value measurements.
 - Clarify ‘narrative description of the sensitivity of fair value measurement to changes in unobservable inputs’ should be a ‘narrative description of the **uncertainty of the fair value measurement as of the reporting date**’.
 - Add:
 - unrealised gains or losses for Levels 1 and 2 in hierarchy; and
 - the range, weighted average and time period used to develop significant unobservable inputs for Level 3 fair value measurements.
- Project on hold pending completion of work on the Disclosure Framework.

Contact us

37

IFRS 13 PIR project



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