IFRS Accounting

Staff paper

Agenda reference: 6B

IFRS® Interpretations Committee meeting

Date	**March 2023**
Project	**Potential annual improvements—disclosure of deferred difference between fair value and transaction price—Guidance on implementing IFRS 7**
Topic	**Initial consideration**
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Introduction

1. We have been informed about an inconsistency between paragraph 28 of IFRS 7 *Financial Instruments: Disclosures* and paragraph IG14 of its accompanying illustrative guidance in the Guidance on implementing IFRS 7[1].

2. The inconsistency arose when, upon the issuance of IFRS 13 *Fair Value Measurement* in May 2011, the International Accounting Standards Board (IASB) made a consequential amendment to paragraph 28 of IFRS 7 but made no corresponding amendments to paragraph IG14 of IFRS 7.

3. This paper:

   (a) provides the Interpretations Committee (Committee) with a summary of the matter;

   (b) presents our research and analysis; and

[1] For brevity, in this agenda paper, we refer to paragraphs in the Guidance on implementing IFRS 7 as paragraphs of IFRS 7.

(c) asks the Committee whether it agrees with our preliminary views to include a proposed amendment to paragraph IG14 of IFRS 7 in the next *Annual Improvements to IFRS Accounting Standards* (annual improvements) cycle.

Structure of this paper

4. This paper includes:

   (a) Background information;

   (b) Staff analysis and preliminary views;

   (c) Question for the Committee;

   (d) Appendix A—recommended proposed amendment to paragraph IG14 of IFRS 7; and

   (e) Appendix B—consequential amendment to paragraph 28 of IFRS 7 upon the issuance of IFRS 13.

Background information

5. Paragraph B5.1.2A(b) of IFRS 9 *Financial Instruments* requires an entity to defer a difference between the fair value at initial recognition of a financial instrument and its transaction price if the fair value is not evidenced by a quoted price in an active market for an identical instrument or based on a valuation technique that uses only data from observable markets. The entity recognises that deferred difference in profit or loss in subsequent periods only to the extent that it arises from a change in a factor (including time) that market participants would take into account when pricing the instrument. The requirements in paragraph B5.1.2A of IFRS 9 were previously in paragraph AG76 of IAS 39 *Financial Instruments: Recognition and Measurement* (as amended at October 2009).

6. The IASB issued IFRS 13 in May 2011 and made consequential amendments to several IFRS Accounting Standards, including to paragraph AG76 of IAS 39 (now

paragraph B5.1.2A of IFRS 9) and paragraph 28 of IFRS 7. As a result of that amendment, paragraph 28 of IFRS 7 states:

> In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of IFRS 9). In such cases, the entity shall disclose by class of financial asset or financial liability:
>
> (a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9).
>
> (b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
>
> (c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

7. Appendix B to this paper reproduces the consequential amendment to paragraph 28 of IFRS 7 upon the issuance of IFRS 13.

8. Paragraph IG14 of IFRS 7 illustrates some of the disclosure requirements in paragraph 28 of IFRS 7. Paragraph IG14 of IFRS 7 states, in part:

> At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets. However, when,

> after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IFRS 9 *Financial Instruments* and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:
>
> …

9. The first two sentences of paragraph IG14 of IFRS 7 reflect prior wording in paragraph 28 of IFRS 7—that is, before paragraph 28 was amended by IFRS 13. As a result, some of the wording in paragraph IG14 of IFRS 7 is not consistent with wording in paragraph 28 of IFRS 7.

Question raised

10. The question raised is whether the IASB should amend paragraph IG14 of IFRS 7 to better align its wording with paragraph 28 of IFRS 7 and eliminate the inconsistency between the two paragraphs.

Staff analysis and preliminary views

11. The May 2011 consequential amendment to paragraph 28 of IFRS 7 updated that paragraph to align it with concepts and terminologies used in IFRS 13. Paragraph 28:

(a) *before the consequential amendment*—required disclosure when there is 'a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique'.

(b) *after the consequential amendment*—requires disclosure when an entity does not recognise a gain or loss on initial recognition (which, applying paragraph B5.1.2A of IFRS 9, is the difference between the fair value at initial recognition and the transaction price). This may occur because the 'fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets'.

12. Furthermore, the consequential amendment added subparagraph 28(c) of IFRS 7 to require disclosure of 'why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value'.

13. None of these changes previously made to paragraph 28 of IFRS 7 are reflected in paragraph IG14 of IFRS 7. Therefore, there is an inconsistency between paragraph 28 of IFRS 7 and its illustrative guidance in paragraph IG14 of IFRS 7.

14. In our view, this matter can be efficiently resolved by amending paragraph IG14 of IFRS 7 to better align its wording with paragraph 28 of IFRS 7 (see Appendix A to this paper). We do not think it is necessary, and we do not recommend, to include amendments to paragraph IG14 of IFRS 7 to illustrate the disclosure requirement in subparagraph 28(c) of IFRS 7.[2]

[2] At its February 2023 meeting, the IASB tentatively decided to propose an amendment to paragraph IG1 of IFRS 7 to add a statement that the implementation guidance accompanying IFRS 7 does not illustrate all the requirements in IFRS 7.

Does this matter meet the annual improvements criteria?

15. Paragraphs 6.10–6.13 of the *Due Process Handbook* include the criteria for annual improvements. To meet these criteria, the proposed solution would need to be limited to:

    (a) clarifying the wording in an Accounting Standard, which involves either replacing unclear wording in existing Accounting Standards or providing requirements where an absence of requirements is causing concern; or

    (b) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements.

16. In our view, our proposed solution to amend paragraph IG14 of IFRS 7 (see Appendix A to this paper) meets these criteria and would efficiently resolve the matter. Such an amendment would improve consistency between paragraph 28 of IFRS 7 and its illustrative guidance in paragraph IG14 of IFRS 7. It would not propose a new (or change an existing) principle or requirement.

17. Although, strictly speaking, an amendment to the Guidance on implementing IFRS 7 may not be required—because such guidance accompanies, but is not part of, an IFRS Accounting Standard—we see benefit in removing the potential for confusion related to paragraph IG14 as described in this paper. We note that the IASB previously amended illustrative examples through annual improvements; Illustrative Example 13 accompanying IFRS 16 *Leases* was amended through *Annual Improvements to IFRS Standards 2018–2020*.

Summary of staff preliminary views

18. Based on our analysis in paragraphs 11–17, our preliminary views are:

    (a) to propose that the IASB amend paragraph IG14 of IFRS 7 to improve consistency with paragraph 28 of IFRS 7 (see Appendix A to this paper); and

    (b) to include this proposed amendment in the next annual improvements cycle.

Question for the Committee

Question for the Committee
Do Committee members agree with our preliminary views as summarised in paragraph 18 of this paper? If 'no', do you have any other suggestions?

Appendix A—recommended proposed amendment to paragraph IG14 of IFRS 7

A1. Our proposed amendment to paragraph IG14 of IFRS 7 is set out below. New text is underlined and deleted text is struck through.

> ~~At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique.~~ In some cases, the transaction price of a financial instrument differs from its fair value at initial recognition, and that fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor is based on a valuation technique that uses only data from observable markets. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IFRS 9 *Financial Instruments* and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with some of the requirements in paragraph 28:
>
> > **Background**
> >
> > On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.
> >
> > The transaction price is ~~of~~ CU15 million ~~is the fair value at initial recognition~~.
> >
> > The entity determines that the transaction price does not represent the fair value of the financial assets at ~~After~~ initial recognition.~~,~~ The ~~the~~ entity applies ~~will~~

~~apply~~ a valuation technique to measure the financial assets' fair value. This valuation technique uses inputs other than data from observable markets.

At initial recognition, the fair value of the financial assets measured using that ~~same~~ valuation technique is ~~would have resulted in an amount of~~ CU14 million, which differs from the transaction price ~~fair value~~ by CU1 million.

The entity has existing differences yet to be recognised in profit or loss of CU5 million at 1 January 20X1.

Application of requirements

The entity's 20X2 disclosure would include the following:

Accounting policies

The entity uses the following valuation technique to measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the ~~fair value at initial recognition (which, in accordance with IFRS 13 and IFRS 9, is generally the~~ transaction price~~)~~ and the fair value measured ~~amount determined~~ at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IFRS 9, the fair value of an instrument at initial recognition ~~inception~~ is normally the transaction price. If the transaction price differs from the fair value measured ~~amount determined~~ at initial recognition ~~inception~~ using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognised in profit or loss are as follows:

	31 Dec X2	31 Dec X1
	CU million	CU million
Balance at beginning of year	5.3	5.0
New transactions	–	1.0
Amounts recognised in profit or loss during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	4.5	5.3

Appendix B—consequential amendment to paragraph 28 of IFRS 7 upon the issuance of IFRS 13

B1. The following table reproduces the consequential amendment made to paragraph 28 of IFRS 7 upon the issuance of IFRS 13. New text is underlined and deleted text is struck through.

Before the consequential amendment	**Consequential amendment made[3]**	**Current version**
If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74–AG79 of IAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of IAS 39 are met. It follows that there could be a difference between the fair value at	~~If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG74–AG79 of IAS 39). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (ie the fair value of the consideration given or received), unless conditions described in paragraph AG76 of IAS 39 are met. It follows that there could be a difference between the fair value at~~	In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph B5.1.2A of IFRS 9). In such cases, the entity shall disclose

[3] In addition to this consequential amendment, upon the issuance of IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) in November 2013, references to paragraphs in IAS 39 were replaced with references to paragraphs in IFRS 9.

<table>
<tr>
<td>initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

(a) its accounting policy for recognising that difference in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price (see paragraph AG76A of IAS 39); and

(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.</td>
<td>~~initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:~~ In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see paragraph AG76 of IAS 39). In such cases, the entity shall disclose by class of financial asset or financial liability:

(a) its accounting policy for recognising in profit or loss the ~~that~~ difference</td>
<td>by class of financial asset or financial liability:

(a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9).

(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.</td>
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</table>

	between the fair value at initial recognition and the transaction price ~~in profit or loss~~ to reflect a change in factors (including time) that market participants ~~would consider in setting a price~~ take into account when pricing the asset or liability (see paragraph ~~AG76A~~ AG76(b) of IAS 39). ~~; and~~ … (c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.	(c) why the entity concluded that the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.