IFRS Accounting

# Staff paper

Agenda reference: 12D

**IASB® meeting**

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| Date | **February 2024** |
| Project | **Annual Improvements to IFRS Accounting Standards—Volume 11** |
| Topic | **Disclosure of Deferred Difference between Fair Value and Transaction Price (Amendments to *Guidance on implementing IFRS 7*): Analysis of feedback** |
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## Introduction

1. As explained in Agenda Paper 12 *Maintenance and consistent application—Cover paper*, this paper analyses feedback on *Disclosure of Deferred Difference between Fair Value and Transaction Price* (Amendments to *Guidance on implementing IFRS 7* Financial Instruments: Disclosures) included in the Exposure Draft *Annual Improvements to IFRS Accounting Standards—Volume 11*. The International Accounting Standards Board (IASB) proposed to amend paragraph IG14 of the *Guidance on implementing IFRS 7* to improve its consistency with paragraph 28 of IFRS 7.

## Summary of staff recommendations

2. We recommend that the IASB finalise the proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7* with a minor wording change as explained in paragraphs 11–13 of this paper and shown in Appendix B to this paper.

## Structure of this paper

3. This paper includes:

   (a) Background information;

   (b) Summary of feedback;

   (c) Staff analysis;

   (d) Staff recommendation and question for the IASB;

   (e) Appendix A—Extract from the Exposure Draft for proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7*; and

   (f) Appendix B—Recommended revised amendment to paragraph IG14 of the *Guidance on implementing IFRS 7* [example omitted].

## Background information

4. Paragraphs BC4–BC6 of the Basis for Conclusions on the proposed amendments to the *Guidance on implementing IFRS 7* in the Exposure Draft explain the background and the IASB's rationale for the proposed amendments. Paragraphs BC4–BC6 state:

   > BC4 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 neither evidenced by a quoted price in an active market for an identical instrument nor based on a valuation technique that uses only data from observable markets. The entity recognises the 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. Paragraph 28 of IFRS 7 requires an entity to disclose information, including

its accounting policy and the aggregate amount yet to be recognised in profit or loss, about the deferred difference between fair value and the transaction price.

BC5 When the IASB issued IFRS 13 in May 2011, it amended paragraph 28 of IFRS 7 to align the wording of that paragraph with the concepts and terminology used in IFRS 13; however, the IASB omitted to amend paragraph IG14 of the *Guidance on implementing IFRS 7*, which illustrates some of the disclosure requirements in paragraph 28 of IFRS 7. As a result, some of the wording in paragraph IG14 is not consistent with the wording in paragraph 28.

BC6 The IASB proposes to resolve these inconsistencies by amending paragraph IG14 to conform its wording with the requirements in paragraph 28 and with the concepts and terminology used in IFRS 9 and IFRS 13. The proposed amendments would also improve the internal consistency of the example in paragraph IG14.

5. As discussed in Agenda Paper 12B for the May 2023 IASB meeting, there was no need for the IASB to propose transition requirements because the proposed amendments are to non-authoritative material accompanying IFRS 7.

6. Appendix A to this paper reproduces the proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7*.

## Summary of feedback

### *Overview of feedback*

7. Thirty-five respondents commented on the proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7*. Almost all respondents agreed with the proposed amendments for the reasons provided in the Exposure Draft. A few respondents provided additional comments that are summarised in paragraphs 8–10 of this paper.

### *Paragraph 28(c) of IFRS 7*

8. A few respondents suggested the IASB further amend paragraph IG14 to refer to the disclosure requirement in paragraph 28(c) of IFRS 7. For example, a group of national standard-setters and a national standard-setter said further amendment is necessary because entities often expect an illustrative example 'to provide a complete and comprehensive response to those requirements rather than a partial view'. These standard-setters suggested the IASB further amend paragraph IG14 to state (text added since the Exposure Draft is bolded and underlined; text deleted since the Exposure Draft is bolded and struck through):

> IG14 […] Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with **~~some of~~** the requirements in <u>**sub**</u>paragraph 28<u>**(a) and 28(b)**</u>**~~:~~**<u>**. In addition to the below, an entity must also disclose information that enables users to understand 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.**</u> […]

### *Additional suggested changes*

9. An accounting firm said paragraph IG14, if amended as proposed, would still be unclear as to what an entity should disclose. In particular, this respondent said if the reference to 'description of the entity's accounting policy' in the example refers to the requirement in paragraph 28(a) of IFRS 7, the example should be clarified. This respondent suggested the IASB amend paragraph IG14 to state (text added is underlined): 'description of the entity's accounting policy <u>with regard to the recognition in profit and loss of the difference that was deferred on initial recognition, arising between the transaction price and the fair value</u>'.

10. A different accounting firm suggested the IASB clarify in paragraph IG14 that it is *only when a valuation technique uses at least one unobservable input* that an entity is required to define and describe its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price.

## Staff analysis

### *Paragraph 28(c) of IFRS 7*

11. We partially agree with respondents' suggestions, as summarised in paragraph 8 of this paper, to further amend paragraph IG14 to refer to the disclosure requirement in paragraph 28(c) of IFRS 7. We disagree with the view that an illustrative example or implementation guidance should be expected to illustrate all the requirements in the referenced paragraph(s) of an Accounting Standard. We note that:
    (a) paragraph IG1 of the *Guidance on implementing IFRS 7* currently states [emphasis added]: 'This guidance suggests possible ways to apply *some* of the disclosure requirements in IFRS 7.' Therefore, complying with the example in paragraph IG14 alone would not be sufficient to comply with all the requirements in paragraph 28 of IFRS 7.

(b) as explained in paragraph 24 of Agenda Paper 12H for the February 2023 IASB meeting, many illustrative examples and implementation guidance already state—in a variety of formats—that they do not illustrate all the requirements in the referenced Accounting Standards.

(c) if the IASB agrees with the staff recommendation in Agenda Paper 12C for this meeting, the amended paragraph IG1 will state [new text is underlined]:

> IG1 This guidance suggests possible ways to apply some of the disclosure requirements in IFRS 7. The guidance does not necessarily illustrate all the requirements in the referenced paragraph(s) of IFRS 7, nor does it create additional requirements.

12. However, because the purpose of the proposed amendments to paragraph IG14 is to improve its consistency with paragraph 28 of IFRS 7, we agree with the respondents' suggestion to refer to—but not illustrate—paragraph 28(c) of IFRS 7 in paragraph IG14. The example in paragraph IG14 predates the 2011 amendments to paragraph 28 of IFRS 7. We therefore recommend changing the wording of paragraph IG14 to clarify that it illustrates only the requirements in paragraph 28(a)–(b) of IFRS 7, but not paragraph 28(c) (text added since the Exposure Draft is underlined; text deleted since the Exposure Draft is struck through):

> IG14 […] An entity might disclose the following to comply with ~~some of the requirements in~~ paragraph 28(a)–(b) ~~paragraph 28~~ (paragraph 28(c) is not illustrated): […]

13. In our view, our recommended changes would:

(a) achieve the IASB's aim to improve paragraph IG14's consistency with paragraph 28 of IFRS 7; and

(b) address respondents' comments without creating expectations that an illustrative example or implementation guidance illustrates all the requirements in the referenced paragraph(s) of an Accounting Standard.

***Additional suggested changes***

14. In our view, the respondents' suggestions summarised in paragraphs 9–10 of this paper go beyond the focus of the proposed amendments to paragraph IG14 to improve consistency with paragraph 28 of IFRS 7. In particular, we think it was intentional that the example in paragraph IG14 states '[description of the entity's accounting policy]' in a general way to avoid being overly specific or prescriptive about the language to be used. We think there could be unintended consequences of making more extensive changes to the wording of the example in paragraph IG14 without issuing those changes for public comment.

15. For these reasons, and considering that almost all respondents agreed with the proposed amendments, we recommend the IASB make no changes to paragraph IG14 in response to the respondents' suggestions summarised in paragraphs 9–10 of this paper.

## Staff recommendation and question for the IASB

16. Based on our analysis in this agenda paper, we recommend the IASB finalise the proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7* with a minor wording change as explained in paragraphs 11–13 of this paper and shown in Appendix B to this paper.

| Question for the IASB |
| --- |
| Does the IASB agree with our recommendation to finalise the proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7* with a minor wording change as explained in paragraphs 11–13 of this paper and shown in Appendix B to this paper? |

# Appendix A—Extract from the Exposure Draft for proposed amendments to paragraph IG14 of the *Guidance on implementing IFRS 7*

| Paragraphs […] IG14 […] are amended. New text is underlined and deleted text is struck through. |
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## Significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)[1] [*footnote omitted*]

…

### Fair value (paragraph 28)

IG14 ~~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.~~ <u>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 based on a valuation technique that uses only data from observable markets.</u> 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 <u>some of the requirements in</u> 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 <u>is</u> ~~of~~ CU15 million ~~is the fair value at initial recognition~~.

<u>The entity determines that the transaction price differs from the fair value of the financial assets at</u> ~~After~~ initial recognition<u>.</u>~~,~~ <u>The</u> ~~the~~ entity <u>applies</u> ~~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 <u>fair value of the financial assets measured using that</u> ~~same~~ valuation technique <u>is</u> ~~would have resulted in an amount of~~ CU14 million, which differs from <u>the transaction price</u> ~~fair value~~ by CU1 million.

At 1 January 20X1, prior to this transaction, the ~~The~~ entity has a balance of existing differences of CU5 million yet to be recognised in profit or loss ~~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—Recommended revised amendment to paragraph IG14 of the *Guidance on implementing IFRS 7* [example omitted]

Paragraph IG14 is amended. New text is underlined and deleted text is struck through.

## Significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)[1] [*footnote omitted*]

…

### Fair value (paragraph 28)

IG14 ~~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 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 paragraphs 28(a)–(b) ~~paragraph 28~~ (paragraph 28(c) is not illustrated):

[example omitted]