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Project	**Disclosure Initiative—Targeted Standards-level Review of Disclosures**		
Paper topic	Drivers of change in fair value measurements		

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Purpose and structure of this paper

1. The objective of this paper is to present staff analysis and recommendations about whether the Board should amend its previous tentative decisions relating to information about drivers of change in fair value measurements. The paper responds to concerns raised by Board Members in the November 2019 and January 2020 Board Meetings.

2. This paper is structured as follows:
   (a) Summary of staff recommendations (paragraphs 3-4);
   (b) Background (paragraphs 5-15);
   (c) Staff analysis (paragraphs 16-26);
   (d) Conclusions and question for the Board (paragraphs 27-29);
   (e) Appendix—Disclosure by level of the fair value hierarchy.

Summary of staff recommendations

3. We recommend that the Board amend its tentative decisions about IFRS 13 disclosure requirements. Specifically, we recommend that the Board:

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(a) make reference to *significant* drivers of change in the objective that requires an entity to disclose information that enables users to understand drivers of change in fair value measurements over the reporting period;

(b) in order to meet this objective, *require* an entity to disclose a reconciliation from opening to closing balances of recurring fair value measurements categorised within Level 3 of the fair value hierarchy. This is similar to the existing requirement in paragraphs 93(e) and (f) of IFRS 13; and

(c) identify an additional item of information that, while not mandatory, may enable an entity to meet the disclosure objective in paragraph 3(a). This item is an explanation of significant drivers of change, if any, in fair value measurements other than those classified in Level 3 of the fair value hierarchy.

4. Indicative drafting for this recommendation is in paragraph 29 of this paper.

Background

Previous Board decisions on IFRS 13

5. At its September 2019 meeting, the Board tentatively decided to include the following specific disclosure objective in IFRS 13:

> An entity shall disclose information that enables users of financial statements to understand the drivers of change in the fair value measurements from the beginning of a reporting period to the end of that period.

6. The Board also tentatively decided to explain in IFRS 13 that users need such information to evaluate how the entity's fair value measurements are affected by significant transactions and other events during the period.

7. In its November 2019 meeting, the Board considered items of information an entity could use to meet this disclosure objective. The Board tentatively decided that:

(a) while not mandatory, the following information may enable an entity to meet the disclosure objective described in paragraph 5:

(i) information about the significant drivers of change during the period (see below), for example by narrative explanation or tabular reconciliation;

(ii) the reasons for any transfers between levels of the fair value hierarchy during the period and the entity's policy for determining when transfers are deemed to have occurred.

(b) Examples of drivers of change include, but are not limited to:

(i) the amounts of any transfers between levels of the fair value hierarchy;

(ii) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised;

(iii) total gains or losses for the period in (ii) above included in profit or loss that is attributable to the change in unrealised gains or losses, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised;

(iv) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in profit or loss in which those gains or losses are recognised;

(v) purchases, sales, issues and settlements;

(vi) effect of foreign exchange rate differences.

Comparison to existing requirements

8. Paragraph 93(e) of IFRS 13 requires an entity to disclose a reconciliation from the opening balances to the closing balances of recurring fair value measurements categorised within Level 3 of the fair value hierarchy. Furthermore, paragraph 93(f) of IFRS 13 requires an entity to disclose, for recurring fair value measurements, information about total gains or losses that are attributable to changes in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period.

9. In terms of practical outcomes, paragraph 93(e) of IFRS 13 differs to the tentative decisions made by the Board in November 2019 in two primary ways:

    (a) it applies *only* to Level 3 fair value measurements. The Board's November 2019 tentative decisions avoided reference to particular levels of the fair value hierarchy. The Appendix to this paper summarises why the Board applied this approach across its November 2019 decisions about IFRS 13 disclosures; and

    (b) it *requires* an entity to provide a reconciliation. The Board's November 2019 tentative decisions treat such a reconciliation as one way to meet the objective, but not the only way. This was in response to feedback from some users of financial statements that they often focus only on particular line items from a reconciliation, and that the reconciliation as a whole is not the most useful information they get about fair value measurements.

Further analysis requested by the Board

10. In making the tentative decisions described in paragraph 7, a few Board members expressed some concerns about whether the effects of IFRS 13 on the Statements of Financial Performance would be adequately disclosed in the financial statements of an entity that chooses not to provide a tabular reconciliation.

11. The Board Members raising these concerns explained that:

    (a) the existing requirements in paragraph 93(e) and 93(f) of IFRS 13 mean it is always possible for a user of financial statements to understand the amounts recognised in the Statements of Financial Performance relating to Level 3 fair value re-measurements.

    (b) this is important information for banking industry regulators and those involved in governance. The information helps them to understand any realised and unrealised gains and losses and understand the 'quality' of such earnings—for example they might view a large unrealised gain relating to a Level 3 instrument differently to that for a Level 1 instrument.

12. Since that meeting, a few Board Members have raised further concerns that the disclosure objective, as drafted in paragraph 5 of this paper, could be interpreted to mean an entity is required to disclose all drivers of change across all fair value measurements in all levels of the fair value hierarchy. This interpretation is beyond the scope that Board Members had in mind when making the November 2019 tentative decisions (see Appendix).

Comparison to tentative decisions on IAS 19 Employee Benefits

13. At its July 2019 meeting, the Board tentatively decided on disclosure objectives for IAS 19 *Employee Benefits*. One of those objectives requires an entity to disclose information that enables users of financial statements to understand drivers of changes in the net defined benefit liability or asset from the beginning of a reporting period to the end of that period. This is similar to the IFRS 13 disclosure objective described in paragraph 5.

14. At its January 2020 meeting, the Board decided that—to comply with the disclosure objective described in paragraph 13—an entity is *required* to disclose a tabular reconciliation of the main drivers of change in the net defined benefit liability or asset ('IAS 19 reconciliation'). This decision is different to the Board's tentative decisions on IFRS 13, where a reconciliation is treated as one way to meet the disclosure objective, but not the only way.

15. At its January 2020 meeting, Board Members supporting an IAS 19 reconciliation requirement gave the following reasons:

    (a) Feedback on the 2011 Agenda Consultation indicated that an important user need is rollforwards of key balance sheet items. Rollforwards allow users to understand how the primary financial statements fit together and make the financial statements more accessible.

    (b) More specifically, Board Members struggled to see how the net defined benefit liability can be understood without a reconciliation.

    (c) Board Members were concerned that, in the absence of a requirement for a reconciliation, companies might provide bland, non-quantitative statements of what the key drivers of change were. Board Members

were concerned this would fail to meet user needs and that the 'gap' between the full reconciliation typically given today and potential boilerplate statements would be concerningly large.

Staff analysis

Drivers of change and reconciliations

16. As described above, the Board has decided that a reconciliation is the only way to meet a driver of change objective for the IAS 19 net defined benefit liability or asset. Some of the Board's rationale related to the benefits of reconciliations generally and was not specific to IAS 19 (see for paragraphs 15(a) and (c)). Consequently, we think that same rationale is applicable when considering how to meet the similar driver of change objective for IFRS 13. In light of the Board's January 2020 decisions, we think it would be hard to justify not requiring such a reconciliation for IFRS 13.

17. Specifically, retaining a reconciliation requirement in IFRS 13 would:
    (a) help users to understand how fair values have moved in the period and how their effects across the primary financial statements fit together;
    (b) ensure an entity cannot disclose only bland, non-quantitative statements about drivers of change; and
    (c) address the Board Member concerns described in paragraph 11.

Scope of an IFRS 13 reconciliation

18. The existing reconciliation requirement in IFRS 13 applies only to fair value measurements classified to Level 3 of the fair value hierarchy. However, the Board's tentative decisions on IFRS 13 disclosure to date avoid reference to particular levels of the fair value hierarchy. The Appendix to this paper summarises why the Board applied that approach.

19. Consistent with the analysis in the Appendix, we continue to think that avoiding reference to particular levels of the fair value hierarchy will help entities to avoid

a checklist approach and apply more meaningful judgement about what to disclose. More specifically, we think it will:

(a) help entities to avoid the lengthy disclosure about immaterial fair value measurements that users consistently tell us they do not use today; and

(b) prompt entities to provide information about fair value measurements that are material to users, even if those measurements are classified in Level 2 of the fair value hierarchy. This is likely to be relevant if, for example, an entity has classified an item that has a significant degree of measurement uncertainty into Level 2 (see Appendix).

20. However, we acknowledge and agree with the concern raised in paragraph 12. That is—the Board's objective, as drafted, could be interpreted as requiring disclosure of all drivers of change across all fair value measurements in all levels of the fair value hierarchy. We think such a scope is not justified by user needs and could be substantially more costly to comply with that today's requirements. Consequently, we think the Board should make clear that its objective does not capture all drivers of change in all fair value measurements.

21. The fair value measurements which users want detailed information about are those that are material, and whose measurement is subject to judgement or uncertainty. As described in the Appendix, this need will always capture Level 3 fair value measurements (if they are material). It may also capture some other fair value measurements if—for example— an entity has any significant items in the 'grey area' between Level 2 and Level 3 classifications (see Appendix) that have been classified to Level 2.

22. In addition, if an IFRS 13 reconciliation is *required* by the Standard, we think the required start and end position of that reconciliation need to be clearly specified. Otherwise, it may be difficult for entities to comply with the requirement and difficult for users to tie the reconciliation to other parts of the financial statements (see paragraph 15(a)).

23. With these considerations in mind, we think the Board should:

(a) refer to 'significant' drivers of change in its objective. We think this will:

(i) make clear that the Board is not expecting disclosure of all drivers of change in all Levels of the fair value hierarchy;

(ii) be consistent with the use of ‘significant’ elsewhere in the Board’s IAS 19 and IFRS 13 proposals (see also paragraphs 24-26 below); and

(iii) be supported by items of information for disclosure and explanatory information in the basis for conclusions, that help an entity to judge when drivers of change are likely to be ‘significant’.

(b) *require* a reconciliation for Level 3 fair value measurements. We think this will:

(i) make clear that if Level 3 fair value measurements are material, information about their drivers of change will always be significant and need to be disclosed;

(ii) ensure that the reconciliation has a defined start and end point that can be tied to other areas of the financial statements (see paragraph 22); and

(iii) achieve the benefits described in paragraph 17 of this paper.

(c) identify that, while not mandatory, additional information about drivers of change in other fair value measurements may enable an entity to meet the disclosure objective. We think this will prompt an entity to consider whether information about any other drivers of change—beyond those in Level 3—would be material to users. We think this is most likely to be the case if an entity has any significant items in the ‘grey area’ between Level 2 and Level 3 classifications (see Appendix) that have been classified to Level 2.

‘Significant’—comparison to other uses in IFRS Standards

24. Our staff recommendation uses the term ‘significant’ consistently with IAS 19 and other IFRS 13 disclosure objectives tentatively decided upon by the Board. At its September and November 2019 Board Meetings, the Board discussed how this use of ‘significant’ compares to other uses of the term in IFRS Standards—most notably, the reference to ‘significant’ accounting policies in IAS 1

Presentation of Financial Statements. This comparison is particularly important given that the Board is currently undertaking a project to replace that use of 'significant' with 'material' (see Agenda Paper 20).

25. As discussed in September and November 2019:
    (a) The current use of significant in IAS 1 is an absolute concept—ie, to apply that requirement, entities need to determine whether an accounting policy is significant or whether it isn't on a standalone basis. The Board has received feedback that stakeholders do not know what makes an accounting policy significant.
    (b) Other uses of significant in IFRS Standards—for example the existing reference to 'significant unobservable inputs' in IFRS 13—are relative to a group of items. Taking a simple example: if an entity has 10 unobservable inputs to its fair value measurements, it will be able to make a relative assessment of which of those 10 have a significant effect on overall fair value.
    (c) In its *Disclosure of Accounting Policies—Proposed Amendments to IAS 1 and IFRS Practice Statement 2* Exposure Draft, the Board did not consider it necessary to propose updating other references to 'significant' across IFRS Standards.

26. For these reasons, we continue to think it is reasonable for the Board to use the term 'significant' in the way envisaged in paragraph 25(b). Similar uses of 'significant' in IFRS Standards are being effectively applied today. Furthermore, we continue to think the items of information supporting the Board's objective will help an entity to interpret this term.

Conclusions and question for the Board

27. In light of the above analysis, we recommend that the Board:
    (a) amend the disclosure objective in paragraph 5 to make reference to *significant* drivers of change;

(b) *require* an entity to disclose a reconciliation from opening to closing balances of fair value measurements categorised within Level 3 of the fair value hierarchy; and

(c) add an additional item that, while not mandatory, may also enable an entity to meet the disclosure objective in paragraph 27(a). This item is an explanation of significant drivers of change, if any, in fair value measurements other than those classified in Level 3 of the fair value hierarchy.

28. For the avoidance of doubt, we do not recommend making any changes to the item of information described in paragraph 7(a)(ii) of this paper.

29. If the Board agrees with the staff recommendation, we envisage the related disclosure objective and items of information to meet that objective being similar to the following:

> An entity shall disclose information that enables users of financial statements to understand the significant drivers of change in fair value measurements from the beginning of a reporting period to the end of that period.
>
> To meet the objective in paragraph X, an entity shall disclose, for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
>
> (i) the amounts of any transfers between levels of the fair value hierarchy;
>
> (ii) total gains or losses for the period recognised in profit or loss, and the line item(s) in profit or loss in which those gains or losses are recognised;
>
> (iii) total gains or losses for the period in (ii) above included in profit or loss that is attributable to the change in unrealised gains or losses, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised;

(iv) total gains or losses for the period recognised in other comprehensive income, and the line item(s) in profit or loss in which those gains or losses are recognised;

(v) purchases, sales, issues and settlements;

(vi) effect of foreign exchange rate differences.

While not mandatory, the following information may also enable an entity to meet the disclosure objective described in paragraph X:

(i) the reasons for any transfers between levels of the fair value hierarchy during the period;

(ii) the entity's policy for determining when transfers are deemed to have occurred; and

(iii) explanation of significant drivers of change, if any, in fair value measurements other than those classified in Level 3 of the fair value hierarchy

Question for the Board

Does the Board agree with the staff recommendation in paragraph 27?

Appendix—Disclosure by level of the fair value hierarchy

A1. The paragraphs that follow are extracted from November 2019 Agenda Paper 11C. The paragraphs explain why the Board's November 2019 tentative decisions avoided reference to particular levels of the fair value hierarchy.

A2. IFRS 13 currently requires a number of disclosures only for items in Level 3 of the fair value hierarchy. Paragraph BC187 of IFRS 13 states that those disclosures were developed in response to user requests for more information about Level 3 fair value measurements.

A3. Since IFRS 13 was issued in May 2011, the Board has received feedback from stakeholders, including preparers and users—through our detailed outreach and the post-implementation review (PIR) of the Standard—on the practical outcome of those specific disclosure requirements.

A4. Preparers tell us these disclosures are costly to prepare and that users rarely have questions about them. Meanwhile, users have expressed concerns about the application of materiality to fair value disclosures. They tell us that preparers often provide detailed information about immaterial fair value measurements and insufficient information about material fair value measurements. For example, if Level 2 fair value measurements are material and Level 3 fair value measurements are immaterial, users tell us they would rather see detailed and relevant disclosures about Level 2 than Level 3.

A5. Furthermore, some users are of the view that if an item falls within the grey area between clearly Level 2 and clearly Level 3, an entity might be motivated to categorise the item as Level 2 to avoid having to prepare detailed disclosures. Users also tell us that, if such 'grey area' items are material, detailed disclosure is important to them.

A6. In light of all feedback received, we think it is unhelpful to list specific items of information for disclosure only for particular levels of the fair value hierarchy. All feedback received indicates that, in practical terms, this approach encourages preparers to:

(a) focus their disclosure on Level 3 fair value measurements, even when these are immaterial; and

(b) disclose little information about other fair value measurements, even where these are material.

A7. Consequently […] we have avoided making reference to specific levels of the fair value hierarchy. We think such an approach is necessary to address the grey areas between items categorised in Level 2 and Level 3 of the fair value hierarchy. However, we acknowledge that this approach would require preparers to make judgements about which items measured at fair value they should provide disclosure for. […]

A8. We think preparers could apply judgment based on the level of subjectivity in an item's fair value measurement. Therefore, we think this approach would not necessitate detailed information for Level 1 items and most Level 2 items. However, we expect material information about Level 2 items that require significant amounts of judgement would be captured by the disclosures.

A9. Some say items requiring a significant amount of judgment would always be categorised in Level 3. However, we understand that this is not the case in practice. Furthermore, we think there will always be a 'grey area' at the boundary between levels. Level 2 items that users would like to see information about are those that are close to the Level 3 'boundary'. We note that any such information constitutes material information about a material item in the financial statements. Consequently, that information is already captured by the overarching requirements of IAS 1 *Presentation of Financial Statements*. We do not expect our recommended approach to result in *any* additional information beyond that which is material and should already be disclosed.

A10. In most cases, we expect the main practical impact of our recommended approach will be to help preparers remove immaterial disclosure from the financial statements. This is because it will discourage companies from applying items of information to all Level 3 items in a checklist fashion and instead to think more broadly about what should be disclosed about their fair value measurements.