



European Securities and
Markets Authority

Report

Review of Fair Value Measurement in the IFRS financial statements



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1 Executive Summary

This report by the European Securities and Markets Authority (ESMA) provides an overview of the application of the fair value measurement and disclosure requirements provided for by IFRS 13 *Fair Value Measurement* as applied by European issuers with the objective of assessing their level of compliance and comparability. With this report ESMA plans to contribute to the Post Implementation Review (PIR) on IFRS 13 that the International Accounting Standards Board (IASB) is currently conducting.

The overview builds on a desktop review of the 2015 annual reports of a sample of 78 issuers and on the evidence from enforcement actions taken by European enforcers on financial statements relating to financial years between 2013 and 2015.

The review addressed the following key topics: (i) fair value disclosures, (ii) unit of account, (iii) impact of a decrease in market activity on the assessment of an active market and orderly transactions; and (iv) valuation adjustments to measure fair value of derivative positions.

Overall, the results show that the requirements of the Standard have generally been well incorporated in the financial statements of the issuers in the sample. However, there is room for improvement in the level of compliance and comparability in the application of the IFRS 13 requirements. In addition, IFRS 13 can be improved to bring more clarity in areas where uncertainty in practice still exists.

Disclosure effectiveness

The disclosures reviewed referred to both recurring and non-recurring fair value measurements. Recurring fair value measurements mainly related to financial instruments and investment properties. Issuers in the sample broadly complied with the minimum specified disclosure requirements. However, in areas such as description of inputs and methodologies used, reasoning for transfers between Level 1 and Level 2 fair values and the description of sensitivities, the disclosures were regarded as either too generic or 'boilerplate' and in selected cases lacked disaggregated information. These areas of attention are broadly consistent with the evidence of enforcement cases.

ESMA highlights to issuers that merely 'ticking the box' and providing the minimum specified disclosure requirements in IFRS 13 may not automatically comply in full with the IFRS 13 disclosure objectives. It is ESMA's expectation that issuers focus on providing information that is relevant for users and exercise greater care to avoid the use of boilerplate language and the presentation of unnecessarily voluminous disclosures. In addition, as fair value measurement is pervasive in IFRS financial statements, ESMA encourages issuers to pay particular attention to the location of fair value disclosures to ensure that users can clearly and easily access the fair value information. As already indicated in the Post Implementation Review of IFRS 3, ESMA reiterates the importance of expanding the scope of IFRS 13 disclosures to the initial measurement of non-recurring fair value measurements. ESMA believes that improvements to the effectiveness of IFRS 13 disclosures could also result from the IASB's *Principles of Disclosure* project and the proposed actions therein to provide clarifications on disclosure objectives, on the location of information and on the disclosure of accounting policies.

Application of the unit of account

Information on the unit of account with respect to whether or not any premiums or discounts have been included in the measurements was limited in the financial statements reviewed.

ESMA urges the IASB to provide clarity on the unit of account and recommends issuers to provide entity-specific disclosure on how they estimated fair value and to explain the rationale for the approach.

Level of market activity and fair value

There was limited evidence from the review that issuers departed from quoted prices as a result of a decrease in the level of market activity. When issuers provided disclosures in this respect, no additional information was provided as to *how* issuers concluded that the decrease in the level of market activity led them to conclude that fair value differed from quoted prices. Evidence from enforcement cases showed that often issuers *automatically* linked the existence of indications that market activity had decreased with the fact that the quoted price or transaction price did not represent fair value.

ESMA encourages issuers to disclose the processes followed and the specific situations where they have concluded that quoted prices or transaction prices did not represent fair value. ESMA also draws the attention of issuers to the requirement for further analysis before concluding that transaction prices and quoted prices do not represent fair value. Appendix B of the Standard provides factors to assess whether there has been a significant decrease in the level of market activity.

Valuation adjustments for derivatives

Information on Credit Valuation Adjustment (CVA) was provided by the majority of issuers with significant derivative balances, while fewer issuers provided information on Debit Valuation Adjustment (DVA) and Funding Valuation Adjustment (FVA). The comparability and relevance of information on these adjustments appeared to be limited due to the lack of qualitative explanations accompanying the quantitative impacts presented. Furthermore, information on inputs and methodologies used to calculate these adjustments was provided only in limited cases. Finally, disclosures on these adjustments were reported in various locations (financial statements, risk report, management commentary) and this reduced the understandability of the information provided.

ESMA encourages issuers to explain the rationale and key determinants of valuation adjustments. ESMA also recommends that concerned issuers closely monitor market developments and ensure that derivative valuation incorporates these adjustments when they are necessary to reflect fair value as required by IFRS 13. Finally, ESMA urges issuers that present information on valuation adjustments outside the financial statements, to ensure that this information is clearly cross-referenced to the financial statements.

Next steps

ESMA expects issuers and their auditors to consider the findings of this review when preparing and auditing the financial statements. ESMA expects national competent authorities will take or have already taken appropriate enforcement actions whenever material misstatements are identified. ESMA and national competent authorities will monitor the progress of those actions.

2 Introduction

1. In 2011, the IASB finalised IFRS 13, a standard developed together with the FASB and converged with FASB ASC Topic 820 *Fair Value Measurements and Disclosures*. Since its first application in 2013, IFRS 13 has provided a single source of guidance for fair value measurement and related disclosure as required or permitted by several IFRSs, thus replacing requirements that, before then, were dispersed across several standards.
2. Based on the experience of the financial crisis that broke out in 2008 it has become clear that increased transparency and enhanced disclosure on fair value measurement is of paramount importance in order to enable investors to understand the underlying uncertainties and extract useful information from the financial statements.
3. The IASB is currently undergoing a post-implementation review of IFRS 13. A first phase of this review was conducted between September and December 2016 and aimed at identifying any major issues that issuers have encountered in implementing the Standard. In January 2017, the IASB decided to proceed with phase 2 of the review by publishing a Request for Information (RfI) to seek input from stakeholders on their experiences with IFRS 13.
4. In order to promote investor protection, ESMA and European enforcers¹ have been continuously monitoring the implementation of IFRS 13 by European issuers. In its 2013² and 2015³ European Common Enforcement Priorities (ECEP), ESMA drew the attention of issuers to the application of IFRS 13 in relation to different topics, including the measurement of non-financial assets and liabilities, the inclusion of non-performance risk in valuation of derivatives, the identification of the unit of account and the disclosures of Level 3 measurements. Between 2014 and 2016 several extracts from the EECS database included enforcement decisions based upon fair value measurement and disclosures⁴.
5. Consistent with its objective to promote the effective and consistent application of IFRS, ESMA remains strongly committed to contributing to the development of a single set of high quality, understandable, enforceable and globally accepted accounting standards.
6. Therefore, this report aims at providing an overview on the level of compliance and comparability of the application of the IFRS 13 requirements and may also serve as feedback to the IASB's RfI on this standard. The report draws on the results of a dedicated desktop review of a selection of European issuers and on the enforcement experience relating to IFRS 13 since 2013.

¹ In November 2016 IAASA published a survey on the application of IFRS 13 by Irish companies.

² Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-1634_esma_public_statement_-_european_common_enforcement_priorities_for_2013_financial_statements_1.pdf

³ Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-1608_esma_public_statement_-_ecep_2015.pdf

⁴ A list of the extracts from the EECS database is available here: https://www.esma.europa.eu/sites/default/files/library/esma32-63-213_list_of_decisions_-_including_20th_extract.pdf

3 Objectives and scope of the report

7. This report aims at providing an overview of the compliance and comparability issues relating to the application of IFRS 13 as identified by European enforcers by means of: (i) an *ad hoc* desktop review of the 2015 IFRS consolidated financial statements of a selection of European issuers; and (ii) evidence from enforcement actions taken by European enforcers on IFRS consolidated financial statements relating to financial years between 2013 and 2015. Through this overview, the report provides observations which may also be useful to the IASB in its RfI on IFRS 13.

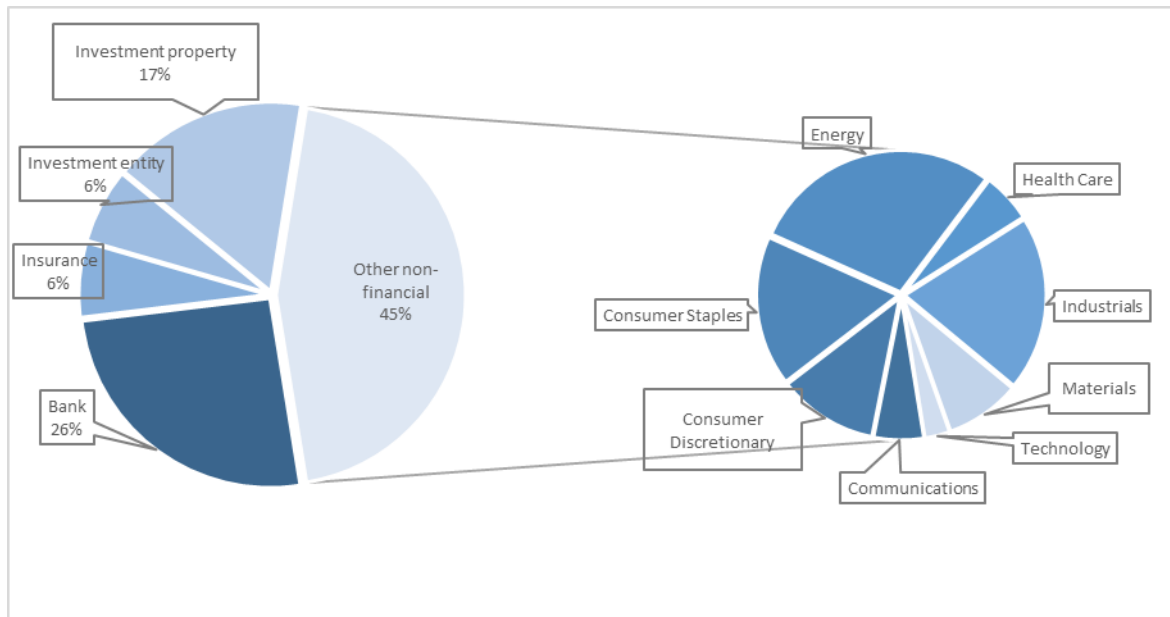
The review

8. The review focussed on four key areas based upon evidence observed from enforcement cases. The areas of focus considered were:
- (a) Fair value disclosures.
 - (b) Unit of account.
 - (c) Impact of a decrease in market activity on the determination of an active market and the assessment of orderly transactions.
 - (d) Valuation adjustments to measure the fair value of derivative positions (credit value adjustment (CVA), debit valuation adjustment (DVA) and funding valuation adjustment (FVA)).
9. The desktop review was based on issuers' published 2015 annual reports. Only in limited instances, was additional information from enforcement cases available for the issuers included in the sample. Therefore, it should be noted that the review provides no insight into the application of measurement techniques and the underlying assumptions. Similarly, due to the inherent limitations of a desktop analysis, the review could not assess why certain disclosures were omitted by issuers.
10. The review was based on a sample of 78 issuers from 28 jurisdictions representing 11% of the total European market capitalisation equalling EUR 1,237 billion⁵. These issuers have been selected taking into account the following aspects: (i) the relative relevance of fair value measurement for the specific issuer; (ii) the wide representation of European jurisdictions; (iii) the balance between issuers belonging to the financial and non-financial sector; and (iv) the presence of both recurring and non-recurring fair value measurements.
11. Within the non-financial sector, particular attention was given to ensuring that the sample included issuers for which fair value was particularly relevant for the measurement of investment properties as well as issuers that qualify as investment entities as defined in paragraph 27 of IFRS 10 *Consolidated Financial Statements*.
12. Within the financial sector, banks and insurance undertakings were selected on the basis of their systemic importance. A number of small and medium size banks were also included in the sample.

⁵ Data based on ECB Statistical Data Warehouse: https://sdw.ecb.int/browseTable.do?removeItem=&SERIES_DENOM=E&ec=&rc=&oc=&df=true&DATASET=0&dc=&node=9691455&pb=&activeTab=

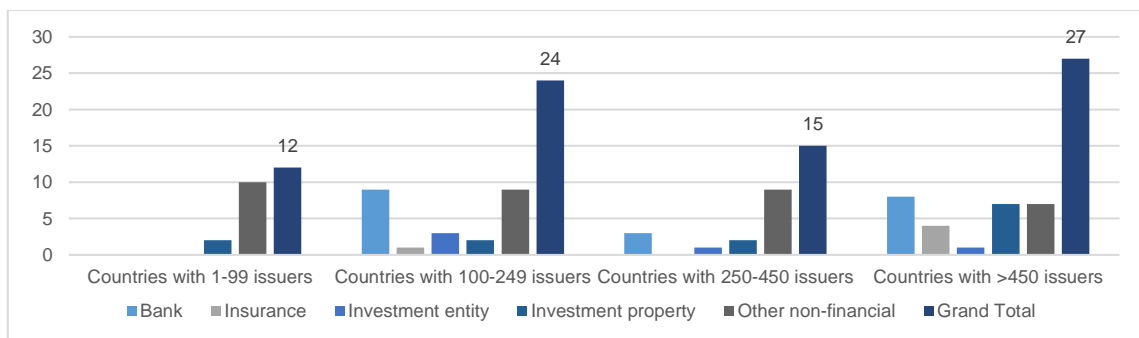
13. The chart below shows a breakdown of the sample by type of issuer, distinguishing between: banks, insurance undertakings, investment entities as defined in IFRS 10, issuers for which the investment property accounted for at fair value as permitted by IAS 40 *Investment Property* was material, and other non-financial issuers belonging to different sectors⁶.

FIGURE 1: SAMPLE COMPOSITION BY TYPE OF ISSUER



14. The chart below presents the composition of the sample by cluster of countries with an indication of the issuer type. The clusters of countries reflect the size of the respective capital markets based on the number of issuers listed on regulated markets in each jurisdiction preparing financial statements in accordance with IFRS⁷.

FIGURE 2: SAMPLE COMPOSITION BY CLUSTER OF COUNTRIES AND ISSUER TYPE

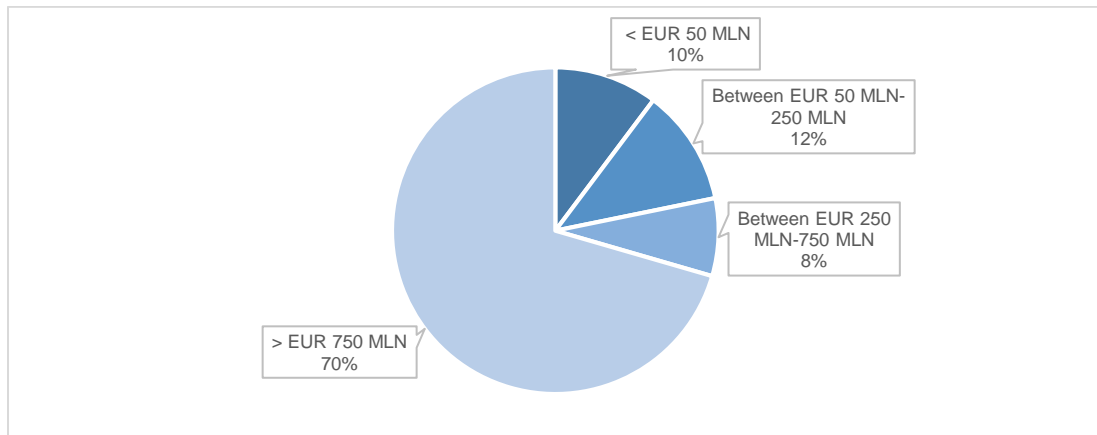


⁶ For the purpose of the study, the sectors identified in the Bloomberg Industry Classification Systems (BICS) were used to breakdown the non-financial entities other than those for which investment properties were material and the investment entities defined according to IFRS 10 which are separately analysed due to the specific relevance of fair value measurement for these type of entities.

⁷ For details of the cluster composition by country, please refer to ESMA's Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2016, p. 24 available at: https://www.esma.europa.eu/sites/default/files/library/esma32-51-382_report_on_enforcement_activities_2016.pdf

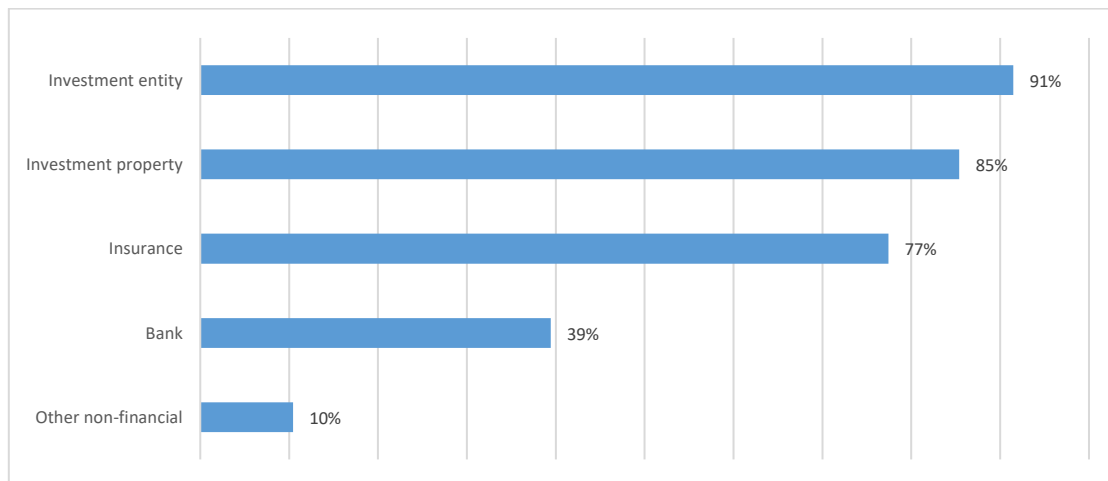
15. The sample was comprised of issuers having a range of amounts of market capitalisation, as shown in the chart below.

FIGURE 3: SAMPLE COMPOSITION BY MARKET CAPITALISATION CLUSTERS



16. As a proxy of the relevance of fair value measurement for the issuers included in the sample, the relative weight of assets measured at fair value on total assets for each issuer was considered. The average relative weight for the sample of issuers used for the review was above 40%; a breakdown of the relative weight by type of issuer is presented below:

FIGURE 4: ASSETS RECOGNISED AT FAIR VALUE AS A PERCENTAGE OF TOTAL ASSETS, ANALYSED BY TYPE OF ISSUER



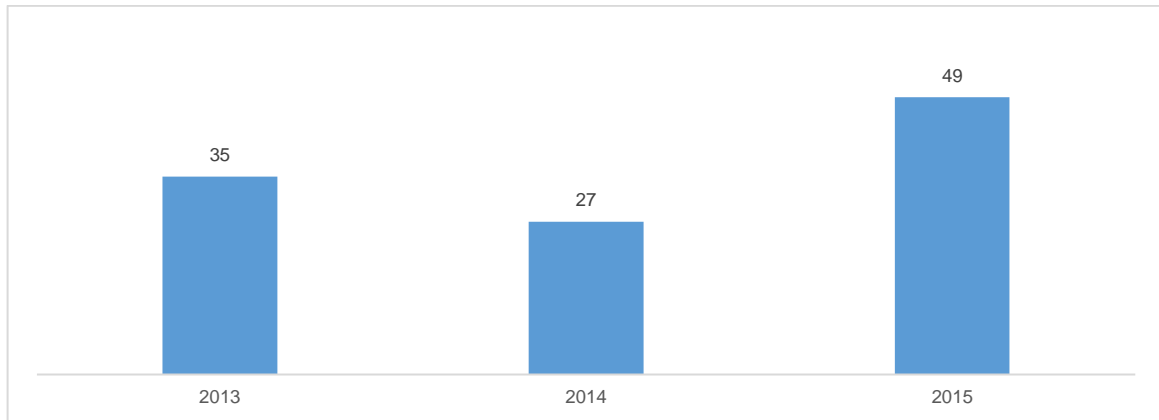
17. When performing this review, ESMA identified examples of fair value disclosures and included them in the Appendix as an illustration of possible ways selected IFRS 13 requirements are implemented in practice. These examples should not be seen as exhaustive or unique, as there might be different ways for meeting IFRS requirements and objectives based on individual facts and circumstances of each financial institution. Accordingly, certain elements of these examples might be further developed in order to better reflect individual circumstances of respective financial institutions. By including these examples in this report, ESMA does not express any view on whether the disclosed

information therein is complete and accurate or on whether it might not be further questioned as part of regular review by national enforcers.

The enforcement activity

18. IFRS 13 has been a topic of specific interest of enforcers for financial years between 2013 and 2015. In aggregate, European enforcers have taken a total of 111 actions with respect to the application of IFRS 13, the distribution of which by reporting period is reported below. The higher number of enforcement actions for 2013 and 2015 financial statements compared to 2014 coincides with the fact that ESMA's ECEP for financial years 2013 and 2015 specifically addressed, among other aspects, the application of IFRS 13. These actions mainly referred to disclosure issues.

FIGURE 5: NUMBER OF ACTIONS TAKEN BY ENFORCERS ON IFRS 13, BY REPORTING PERIOD



4 Overview of IFRS requirements

19. IFRS 13 applies when other IFRSs permit or require fair value measurements or disclosures. However, IFRS 13 excludes from its scope transactions that are accounted in accordance with IFRS 2 *Share-based Payment* and IAS 17 *Leases* (and IFRS 16 *Leases*). Furthermore, IFRS 13 disclosures do not apply to fair value measurements of certain transactions that are in the scope of IAS 19 *Employee Benefits*, IAS 26 *Accounting and Reporting by Retirement Benefit Plans* and IAS 36 *Impairment of Assets*.
20. Since its finalisation, IFRS 13 has been subject to only limited amendments which did not modify the cornerstones on which IFRS 13 is based: (i) a single definition of fair value (paragraph 9) complemented by specific measurement guidance; and (ii) enhanced, objective-based disclosures (paragraphs 91-99).
21. IFRS 13 defines fair value, and provides a framework for its measurement and for the related disclosures. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
22. Irrespective of whether observable market transactions and market information are available for a specific asset or liability, according to IFRS 13, the measurement objective is the same: to estimate an exit price from the perspective of a market participant by maximising the use of observable inputs and minimising the use of unobservable inputs (paragraph 61). Therefore, when measuring fair value, an entity's intention to hold an asset or to discharge a liability is not relevant.
23. IFRS 13 specifically provides for a three-tier hierarchy of fair value measurement depending on the types of inputs which are used to estimate fair value (paragraphs 72-90). The range extends from unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) to unobservable inputs (Level 3). Level 3 inputs are particularly relevant as they are unobservable, therefore the extent to which an entity exercises judgement in determining fair value on the basis of those inputs may be significant.
24. The relevance of Level 3 inputs is evident from additional disclosure requirements which address recurring fair value measurements using unobservable inputs, for example, sensitivity of fair value to changes in those inputs (paragraph 93(h)). Disclosure requirements in IFRS 13 are based on general objectives with detailed requirements on how issuers shall meet these objectives. Beyond the detailed requirements, issuers are encouraged to provide additional disclosures when they are necessary to meet the general objective (paragraph 92).

5 Results

25. This section presents:

- (a) ESMA's findings from the desktop review;
- (b) a summary of the evidence from EECS enforcement cases for financial statements relating to financial years between 2013 and 2015⁸; and
- (c) ESMA's conclusions for issuers and the IASB.

26. Other evidence from enforcement cases that is not specific to any of the topics addressed in the desktop review, is presented in sub-section 5.5.

5.1 Fair value disclosures

Background

27. IFRS 13 includes requirements on the information that issuers shall disclose in the notes to the financial statements based on disclosure objectives that are differentiated between recurring and non-recurring fair value measurements (paragraph 91) as explained in the following paragraph.

28. For recurring, subsequent fair value measurements (in the statement of financial position), the Standard requires an entity to disclose information that help users to assess the valuation techniques and inputs used to develop those measurements (paragraph 91(a)); and, when significant unobservable inputs are used, an entity shall also provide disclosure on the effect of the measurements on profit or loss or other comprehensive income for the period (paragraph 91(b)).

29. For non-recurring fair value measurements (paragraph 91(a)), the Standard requires issuers to disclose information that help users to assess the inputs and valuation techniques used to measure fair value after initial recognition in the statements of financial position.

30. These objectives are complemented by detailed disclosure requirements (paragraph 93) which represent the *minimum* information⁹ that an entity shall disclose in order to meet the objectives. IFRS 13 also requires issuers to provide more information (paragraph 92), to adjust the level of aggregation/disaggregation or the emphasis placed on different items of disclosure and to take into account the specific needs of users of financial statements, when preparing their disclosures on fair value measurement. Finally, paragraphs 94-99 of IFRS 13 contain additional disclosure requirements.

31. ESMA, in both its ECEP 2013 and 2015, has emphasised the importance of providing information that is relevant to meet the disclosure objectives in IFRS 13. Particularly, ESMA has emphasised the importance of the disclosure on the following items: (i) the Level 2 and Level 3 measurements including when fair value is based on external valuations; (ii) any

⁸ Enforcement evidence is available for each topic, except for the valuation adjustments to measure fair value of derivative positions.

⁹ These minimum requirements shall always be fulfilled unless information relating to a specific disclosure is immaterial.

changes in valuation techniques accompanied by appropriate reasoning; and (iii) the use of unobservable inputs and the related sensitivities. ESMA also recalled that relevant information should be provided also when fair value is determined by third parties.

32. ESMA has therefore investigated the level of effectiveness of the IFRS 13 disclosures for the issuers included in the sample having regard to both recurring and non-recurring fair value measurements and placing particular focus on the information provided on the use of Level 3 inputs.

Findings

Recurring fair value measurement (paragraphs 91(a), (b), 93)

Fair value hierarchy (paragraph 93(b), (c))

33. For the majority of the issuers in the sample, recurring fair value disclosures were presented for measurements relating to IAS 39 and IAS 40. 94% of the issuers in the sample disclosed information on the fair value hierarchy. Of those 27% reported transfers among fair value levels. In the majority of cases, the reasoning of the transfers (60%) and the policy for transfers inside and outside the respective levels (75%) was disclosed. However, 25% of the issuers disclosing the reasoning of the transfers, provided disclosures which were regarded as either boilerplate or very generic and thus of limited benefit to users.

Level 2 measurements (paragraphs 93(a), (d))

34. More than one third of the issuers reporting Level 2 measurements (74% of the sample) disclosed valuation techniques in a way that was regarded as boilerplate. The majority of these were issuers with larger market capitalisation (beyond EUR 250 million) and were across all sectors. Most of these issuers made reference to the use of a combination or a set of 'possible' valuation approaches (e.g. income approach or market approach) and this is generally consistent with either the application of fair value according to a number of different standards or, within the same standard, for example IAS 39, with the measurement of assets and liabilities having different characteristics.
35. Regarding the inputs used, the majority of issuers disclosing Level 2 inputs, provided either no description of these inputs or a boilerplate description. This was the case mostly for issuers with market capitalisation beyond EUR 750 million with a relatively higher concentration for insurers and banks.

Level 3 measurements (paragraphs 93(a), (d), (e), (f), (g), (h))

36. The issuers reporting level 3 measurements (78% of the sample) provided disclosures on valuation approaches, the description of which was regarded as boilerplate in 5% of cases. The description of Level 3 inputs was provided in 94% of the cases and in 15% of cases the disclosure was regarded as boilerplate. The valuation approaches reported, similar to Level 2 measurements, are both income and market approaches in most cases.
37. Paragraph 93(g) of IFRS 13 requires disclosures regarding the valuation process followed for Level 3 measurements. As an example of such disclosures, the Standard indicates information on how an entity decides its valuation policies and procedures and on how it analyses changes in fair value measurements from period to period. ESMA analysed whether issuers provided disclosures of valuation policies in line with these examples.

38. The majority of issuers reporting information on Level 3 measurements provided disclosures on how the entity decides its valuation policies. However, 13% of the issuers in the sample with material Level 3 measurements did not provide this information. Regarding the type of the information disclosed, however, only a few issuers provided information in line with the examples provided by the IASB in the Illustrative Example no. 18. For example, the majority of issuers disclosing information on Level 3 fair value measurement did not provide information of how it analyses changes in fair value measurements from period to period.

39. In addition, for Level 3 measurements in only one case did an entity reported the occurrence of a change in the application of a valuation technique due to changes in market conditions. A few issuers did not disclose or disclosed only incomplete quantitative information on the significant unobservable inputs for material Level 3 measurements.

Use of third party pricing (paragraph 93(d))

40. With reference to both Level 2 and Level 3 measurements 67% of the issuers in the sample disclosed that they used either third party pricing (12%), internal data (10%) or both (45%) for their fair value measurements. However, the majority of issuers disclosing the use of third-party pricing did not provide disclosure as to how they concluded that these inputs were in compliance with IFRS 13.

Narrative description of the sensitivity of fair values (paragraph 93(h))

41. 56% of the issuers in the sample provided a narrative description of the sensitivity of fair values to changes in unobservable inputs, if a change in those inputs potentially results in significantly different measurements. However, of those, one quarter presented disclosures which were described as boilerplate while 9% of the total issuers did not provide this disclosure, even though they were expected to do so. Only 20% of the issuers in the sample, disclosed the existence of any interrelationships between unobservable inputs complemented by their description and how they might have an effect on the changes in these inputs. 6% of the issuers in the sample did not provide this disclosure even though they were expected to do so.

42. 42% of the issuers in the sample disclosed the fact that changing any of the unobservable inputs in the measurement of financial assets or liabilities, to reflect reasonably possible alternative assumptions, would change fair value significantly. Of those, 85% also disclosed the quantitative effect, but only 54% of them accompanied this quantification with an explanation of how this effect was calculated.

Non-Recurring fair value measurement (paragraphs 91(a), 93(a), (b), (d), (g), (i))

43. Several standards that require or permit non-recurring fair value measurements are excluded from the scope of the disclosure requirements of IFRS 13. This is the case, for example, in IAS 36, when the recoverable amount is measured as fair value less cost of disposal, or in IFRS 3 *Business Combinations* as the IFRS 13 disclosures address only the *subsequent* measurement of non-recurring fair value measurements.

44. For this reason, the study has focused on those issuers which have disclosed information on fair value relating to the application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. These issuers represented 12% of the total sample.

45. The majority of the issuers provided fair value disclosures for assets held for sale or for disposal groups, when relevant, for both Level 2 and Level 3 measurements. However, very few disclosed the specific valuation techniques adopted and inputs used.

Other disclosures

Highest and best use (paragraph 93(i))

46. None of the issuers concerned reported that current use of the asset differed from its highest and best use.

Fair value of assets which are not measured at fair value (paragraph 97)

47. Regarding assets not measured at fair value but for which the disclosure of fair value was required (paragraph 97 of IFRS 13; for example in accordance with IFRS 7 *Financial Instruments: Disclosures* or IAS 16 or IAS 40), 44% of the issuers in the sample disclosed this information and the related level in the hierarchy. Most of the issuers which did not disclose this information, indicated that the disclosure requirement was not applicable because the carrying amount was equal to or approximates fair value. However, 21% of these issuers did not report information regarding the inputs, valuation techniques and, for Level 3 fair values, the quantitative information about any significant unobservable inputs.

Fair value of liabilities which are not measured at fair value (paragraph 97)

48. Regarding the liabilities not measured at fair value, but for which fair value was disclosed (paragraph 97 of IFRS 13), 49% of the issuers in the sample provided this information. In most cases, the issuers which did not disclose this indicated that the disclosure requirement was not applicable because the carrying amount of the liability approximated fair value. Almost one third of the issuers which provided disclosure on the fair value and the related hierarchy, did not provide information on the inputs and valuation techniques used and they did not provide quantification of any significant unobservable inputs.

Third party credit enhancements (paragraph 98)

49. ESMA also considered the disclosure of any inseparable third party enhancement issued with a financial liability measured at fair value and found that only two issuers in the sample disclosed the existence of such features in the measurement of the fair value of liabilities. However, it was not possible to assess whether or to what degree the absence of this disclosure represented a lack of compliance with IFRS 13.

European Enforcers' overall assessment on IFRS 13 disclosures

50. ESMA asked European enforcers to provide an overall assessments of the IFRS 13 disclosure for the issuers in the sample with respect to two specific areas: (i) quantitative disclosures; and (ii) level of detail of fair value measurement disclosures.
51. With respect to quantitative disclosures, information on sensitivity analysis was identified as an area where some issuers, mainly banks, insurance companies and investment property issuers provided particularly good practices. Enforcers noted that this information was relevant to provide insights of how the entity's fair value measurements were affected by the economic cycle.
52. Regarding the level of detail of the disclosure provided on the measurement policies and methodologies, examples of good practices were identified when structured information for each class of asset or liability indicating the inputs used and the related technique applied was presented. This was the case mainly for financial institutions. In general, significant

areas for improvement were identified in the disclosures relating to the judgments of issuers and in the use of boilerplate language, for example when an entity merely reproduces the text of the Standard without providing any entity-specific information as to how it was applied.

Evidence from enforcement activity

53. Most of the enforcement actions on IFRS 13 taken by European enforcers for financial statements issued between 2013 and 2015 related to disclosures issues. The evidence from these enforcement cases is broadly aligned with the evidence described in the above paragraphs. In addition, enforcers challenged the assessment of issuers with respect to missing fair value disclosures on financial instruments in interim financial statements (according to paragraph 16A(j) of IAS 34 *Interim Financial Reporting*) and on key unobservable inputs. In one case the enforcer disagreed with an issuer's decision not to provide the detailed information required by paragraph 93 of IFRS 13 for all the unobservable inputs it had disclosed to be key¹⁰.

Conclusions for issuers

54. The study has shown that the disclosures on recurring fair value measurements sometimes lack a sufficient level of detail with respect to the entity's key fair value judgements, valuation approaches and significant inputs used. Sometimes, for example, the description of observable and unobservable inputs is limited to a repetition of the Standard and does not provide useful information to users. Fair value disclosures would be improved where issuers added entity-specific disclosures to enhance the users' understanding of the entity's fair value adjustments.

55. ESMA therefore urges issuers to ensure that the disclosures provided on fair value measurements are *in substance* appropriate to meet the disclosure objectives in IFRS 13. In this respect, disclosures that merely fulfil the objective of 'ticking the box' of the minimum requirements in IFRS 13 would be inconsistent with paragraph 92 of that Standard. Therefore, when preparing the fair value measurement disclosures, ESMA expects issuers to increase their efforts to avoid the use of boilerplate language and the presentation of unnecessarily voluminous disclosures and to focus on providing information that is relevant for users.

56. Finally, as fair value measurement is pervasive in IFRS financial statements, ESMA also encourages issuers to pay particular attention to the presentation of fair value disclosures to ensure that users can clearly and easily access this information.

Conclusions for the IASB

57. ESMA would like to emphasise the importance of *better* quality of fair value disclosure. In ESMA's view, the quality of the fair value disclosures is as important as meeting the specified minimum disclosure requirements in IFRS 13 (and IAS 1 *Presentation of Financial Statements*, where applicable).

¹⁰ ESMA, 19th Extract from the EECS's Database of Enforcement: Decision ref EECS/0116-05 – Identification of unobservable inputs.

58. In this respect, ESMA strongly supports the IASB's work towards the improvement of communication in financial statements and particularly expects that the IFRS 13 disclosures will also benefit from the IASB's work on *Principles of Disclosure* for what concerns clarifications on disclosure objectives and role of the notes, on the location of information and on the effective disclosure of accounting policies.
59. However, in its contribution to the IASB's Post Implementation Review on IFRS 3¹¹, ESMA recommended that: "disclosures required by IFRS 3 relating to valuation techniques used in business combinations for assets, liabilities and NCI could be enhanced if they were harmonised with the disclosures required by paragraphs 91-99 of IFRS 13". Therefore, ESMA reiterates the importance of expanding the scope of IFRS 13 disclosures to the initial measurement of non-recurring fair value measurements.

¹¹ ESMA, Review on the application of accounting requirements for business combinations in IFRS financial statements, 2014.

5.2 Unit of account

Background

60. IFRS 13 (Appendix A) defines unit of account as the level at which an asset or a liability is aggregated or disaggregated for recognition purposes. The unit of account (paragraph 13) may be either a stand-alone asset or liability or a group of assets and/or liabilities (e.g. a cash-generating unit (CGU) or a business).
61. IFRS 13 requires an entity to select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account when transacting an asset or a liability (paragraph 11). However, there is a potential lack of clarity in the Standard regarding the unit of account due to the interaction between the requirements in paragraphs 69 and 80 of IFRS 13.
62. On one hand, paragraph 69 requires issuers to select inputs that are consistent with the characteristics of the asset or liability, including adjustments, such as a control premium or non-controlling interest discount, provided that these adjustments are consistent with the unit of account in the IFRS that requires or permits the fair value measurement. As a result, in these cases the fair value of an investment may not be the result of the product of the unadjusted quoted price ('P') times the number of instruments ('Q') or 'P×Q'.
63. On the other hand, paragraph 80 requires an entity holding a position in a single asset or liability traded in an active market (including a position comprising a large number of identical assets and liabilities, such as a holding of financial instruments) to measure the fair value of that asset or liability within Level 1 as P×Q.
64. Particularly, for investments in subsidiaries, joint ventures and associates which are quoted in an active market, divergent views have developed whether an issuer should consider that there is no Level 1 input for the specific unit of account and therefore measure the investment as a whole using a valuation model; or the investment should be regarded as composed of individual financial instruments that have a quoted price (Level 1) and therefore its fair value is calculated as P×Q.
65. Due to divergent views of market participants, in its ECEP for the 2013 financial statements, ESMA expected issuers to disclose their analysis regarding their judgements as to the unit of account. This study concentrates on the unit of account and fair value measurement for quoted investments.
66. IFRS 13 (paragraphs 48-52) also allows issuers to apply an exception to measure the fair value of a group of financial assets and financial liabilities, under certain conditions, on the basis of the exit price of the related net risk exposure in an orderly transaction at the measurement date under current market conditions.
67. In 2014, the IASB issued an Exposure Draft¹² (ED) to propose that the fair value of investments in subsidiaries, joint ventures and associates should reflect the measurement

¹² The IASB's ED *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value* is available here: <http://www.ifrs.org/Current-Projects/IASB-Projects/FVM-unit-of-account/Exposure-Draft-September-2014/Documents/Exposure-Draft-Measuring-Quoted-Investments-September-2014.pdf>

of the investment as a whole. In addition, the IASB proposed that, if those investments are made up of financial instruments that have a quoted price in an active market, IFRS 10, IAS 27 and IAS 28 should be amended to clarify that their fair value measurement should be the product of PxQ. ESMA agreed with these proposals in its comment letter¹³ to the ED. In 2016 the IASB decided to discontinue this project in order to address these issues as part of the post-implementation review of IFRS 13.

Findings from the review

68. For 18% of the issuers in the sample the issue of the unit of account was relevant, either because they measured quoted investments in other issuers at fair value¹⁴ on a recurring or non-recurring basis or because they disclosed transactions with quoted investments that have resulted in a change in the level of control. For these issuers, the reasons for the fair value measurement included the following: (i) measurement of a subsidiary for impairment test purposes, (ii) classification as held for sale according to IFRS 5, (iii) loss of control while retaining a minority stake in a disposal, (iv) step acquisition and (v) application of the investment entity consolidation exemption in IFRS 10.
69. While some issuers (10%) disclosed the use of unadjusted quoted prices, none of the issuers disclosed whether a premium or a discount was applied to the quoted price.
70. ESMA also considered how the unit of account was applied to the measurement of a CGU under IAS 36 when the recoverable amount equals fair value less cost of disposal and the CGU is or includes, an entity quoted in an active market. Although 17% of the issuers in the sample indicated that they had CGUs that were or included quoted issuers, 69% of those indicated that the recoverable amount was measured using the value-in-use and not the fair value less cost of disposal. The remaining issuers indicated that the CGU was measured by reference to the quoted price of the listed entity.
71. Finally, only 10% of the entities – mostly banks – disclosed that they have adopted the exception in IFRS 13 to measure the fair value of a group of financial assets and liabilities at the price of the net exposure.

Evidence from enforcement activity

72. In some enforcement cases related to both acquisition of control (following a step-up acquisition from a position of significant influence) and loss of control (followed by the retention of a significant influence), issuers indicated that the quoted prices of the related investments had to be adjusted to reflect either a control premium or the existence of significant influence. Issuers were asked by the enforcers to provide convincing evidence that an adjustment to quoted prices was needed. For example, evidence should be provided that the adjustment is made on a reliable measurement basis and maximises the use of observable inputs. In some cases, issuers have reverted to PxQ as enforcers have requested more clarity on the reasons underlying the adjustments made to quoted prices and their observability.

¹³http://eifrs.ifrs.org/eifrs/comment_letters/42/42_4336_StevenMaijorESMA_0_2014ESMA1451CLtotheIASBEDMeasuringQuotedInvestmentsinSubsidiariesJVandAssociatesatFV.pdf

¹⁴ The focus of this part of the study was on issuers with investments for which the interaction between paragraphs 69 and 80 of IFRS 13 could be relevant. For this purpose, investments accounted for as financial instruments according to IAS 39 *Financial Instruments: Recognition and Measurement*, except for investment entities, were considered as not relevant.

Conclusions for issuers

73. Instances of where premiums or discounts have been included in the fair value measurements appeared to be limited in the IFRS financial statements of the issuers included in the sample. Even when issuers held quoted investments in other issuers or when changes in control had occurred, from the information available it was not clear whether or not quoted prices were adjusted and, if so, how.
74. Notwithstanding that this is an area of IFRS 13 where clarity of the requirements could be improved, ESMA urges issuers to provide entity-specific disclosure on how they estimated fair value when P×Q was not applied and to explain the rationale for the approach.
75. Furthermore, ESMA notes that IFRS 13 requires issuers to maximise the use of observable inputs and minimise the use of unobservable inputs. Therefore, if issuers make significant adjustments to quoted prices, e.g. leading to the fair value of an investment in an entity quoted in an active market classified as a Level 3 measurement, ESMA expects that specific disclosures would be provided regarding the specific inputs used to make these adjustments.

Conclusions for the IASB

76. Evidence from European enforcement cases shows that there is still lack of clarity in the requirements in IFRS 13 relating to the adjustments applicable when measuring the fair value of quoted issuers. Therefore, ESMA urges the IASB to provide additional guidance and clarification on the interaction between paragraphs 69 and 80 of IFRS 13. Particularly it is not clear whether and under which circumstances the general principle of maximising the use of observable inputs (unadjusted P×Q) or the requirement to consider the characteristics of the unit of account (adjustments for control premium) has more weight.

5.3 Impact of a decrease in market activity on the determination of an active market and the assessment of orderly transactions

Background

77. According to IFRS 13, when the level of market activity shows a significant decrease, the quoted price or transaction price may no longer represent fair value (paragraph B37). Assessing whether there has been a decrease in the level of market activity is also important because fair value measurements assumes that the asset or liability is exchanged in orderly transactions (paragraph 15) and this assumption may no longer hold when the level of market activity decreases (paragraph B43). IFRS 13 provides indicators (paragraph B37) to assess the relevance and significance of a decrease in market activity.
78. However, IFRS 13 does not define quantitative criteria to indicate when a market is no longer active. If an entity concludes that there has been a significant decrease in the level of market activity, further analysis of the transactions or quoted prices is necessary. On that basis, if an entity determines that transaction or quoted prices do not represent fair value, an adjustment to the transaction or quoted prices will be necessary (paragraph B38).
79. ESMA has investigated whether disclosures provided information on the issuers' assessment of whether quoted or transaction prices differed from fair value due to an insufficient level of market activity.

Findings from the review

80. 17% of the issuers in the sample disclosed a deviation from quoted prices, the majority of which were banks. The most common reason disclosed for deviating from quoted prices (sometimes as part of the accounting policy section) was the existence of a low number of transactions in the specific market or, more generically, a significant decline in market activity.
81. Other reasons, either disclosed or arising from the evidence of enforcement actions, included the following: the widening of bid-ask spreads, a significant increase in implied liquidity risk premiums, yields or performance indicators and the substantial variability of market quotations over time or among market makers.
82. While these indicate a decline in market activity, no additional information was provided as to how issuers concluded that the decrease in the level of market activity led them to conclude that fair value differed from quoted prices.
83. Finally, other issuers stated in general terms that if significant unobservable inputs are used in a valuation technique, then a financial instrument is recognised at the transaction price. The issuers referred to paragraphs 43 and AG 76 of IAS 39.

Evidence from enforcement activity

84. The departure from quoted prices in several enforcement cases was justified on the basis that the reference market was not deemed to be active due to a decrease in the level of

market activity¹⁵ or due to the reference stock market being classified as 'emerging' and subject to some short-term restrictions¹⁶. Although, issuers could provide evidence that, on the basis of the indicators provided in paragraph B37 of IFRS 13, a significant decrease in the level of market activity had occurred, they had not complemented this evidence with further analysis as required by paragraph B38 of IFRS 13 to conclude that a market is not active (see also BC 134).

85. Similarly, in a business combination¹⁷, the absence of other market participants for the acquired businesses was not deemed by enforcers as sufficient evidence alone to demonstrate that the transaction price differed from fair value.
86. In another case, in estimating the fair value of an asset, the issuer used broker estimates. However, due to the limited number of orderly transactions, the enforcer came to the conclusion that the issuer had to make its own assessment of fair values based on a valuation model using reasonable inputs in order to justify the fair value provided by the broker.

Conclusions for issuers

87. In most cases, only a generic reference to the existence of adjustments to or deviations from quoted prices was made in the financial statements. Generic statements on the *possibility* that quoted prices or transaction prices may be adjusted leave it open for users the question as to whether the entity has *actually* made adjustments. Therefore, ESMA suggests that when providing the disclosures required by paragraph 93(d) of IFRS 13 issuers make clear whether and why transaction prices have been adjusted.
88. The assessment underlying the conclusion that quoted or transaction prices do not represent fair value is significant for a users' complete understanding of the information conveyed by the fair value hierarchy disclosures, ESMA encourages issuers, based on paragraph 92 of IFRS 13, to disclose the processes followed and the specific situations where they have concluded that quoted prices or transaction prices did not represent fair value with an explanation of the underlying reasons.
89. Finally, ESMA draws issuers' attention to the requirement (paragraph B38) for further analysis before concluding that transaction prices and quoted prices do not represent fair value.

Conclusions for the IASB

90. ESMA believes that additional examples could be helpful to explain what an additional analysis according to paragraph B38 of IFRS 13 could be and how an entity shall assess the significance and relevance of the factors listed in Appendix B.

¹⁵ ESMA, 17th Extract from the EECS's Database of Enforcement: Decision ref EECS/0115-03 – Measurement of financial instruments at fair value.

¹⁶ ESMA, 16th Extract from the EECS's Database of Enforcement: Decision ref EECS/0214-02 – Fair value of consideration paid in shares.

¹⁷ ESMA, 17th Extract from the EECS's Database of Enforcement: Decision ref EECS/0115-04 – Fair value measurement in business combination.

5.4 Valuation adjustments to measure the fair value of derivative positions (CVA, DVA and FVA)

Background

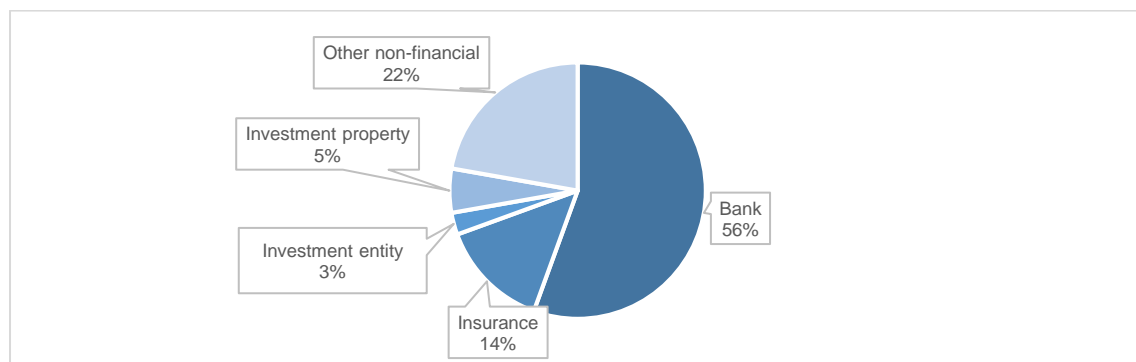
91. IFRS 13 requires an entity to measure fair value using assumptions that market participants would use when pricing the asset or liability (paragraph 22). Specifically, IFRS 13 requires (paragraph 42) that, when measuring the fair value of a liability, an entity shall reflect the effect of non-performance risk which includes, but is not limited to, an entity's own credit risk.
92. Adjustments relating to counterparty risk (CVA), to own performance risk (DVA) or to the cost of funding uncollateralised or partially collateralised derivative transactions (FVA) are commonly used when measuring the fair value of derivatives, however FVA has only recently become market practice in the banking sector. Furthermore, market practice is currently being developed introducing other valuation adjustments, such as KVA (capital valuation adjustment) or MVA (margin valuation adjustment).
93. In its ECEP for 2013 financial statements, ESMA highlighted the importance of including CVA and DVA in the fair value measurement of financial instruments and to provide an appropriate level of transparency regarding the methodologies applied and, if significant, the amounts recognised.

Findings from the review

Sub-sample considered for this topic

94. Information on CVA was disclosed by 46% of the issuers in the sample, 37% disclosed information on DVA and 19% on FVA. Further analysis was performed on a sub-sample of 36 issuers (46% of the total sample) for which information on CVA, DVA and FVA was deemed to be relevant on the basis of the respective derivative exposures (either assets or liabilities).
95. 92% of the issuers of this sub-sample were issuers with market capitalisation above EUR 750 million, belonging primarily to the financial sector, though a number related to non-financial sectors (see figure 6 below).

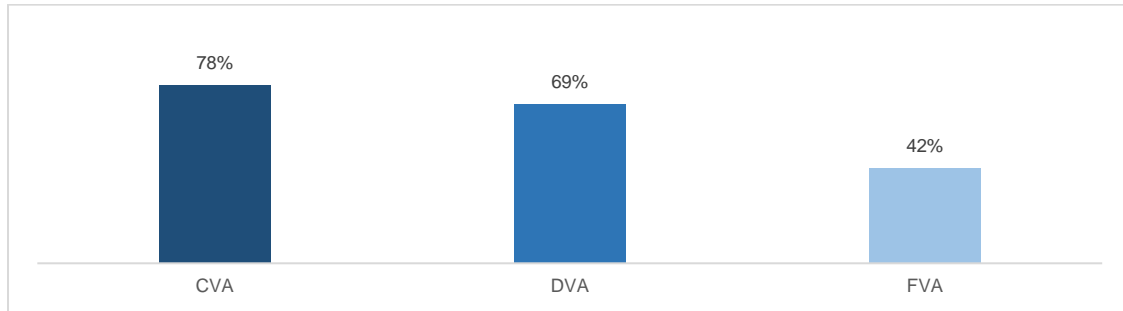
FIGURE 6: SUB-SAMPLE FOR CVA-DVA-FVA, BY TYPE OF ISSUER



General disclosures on CVA, DVA and FVA

96. In general, a higher number of issuers provided at least some disclosures on CVA and DVA than provided disclosures on FVA, as depicted in the chart below.

FIGURE 7: ANY DISCLOSURE ON CVA, DVA AND FVA PROVIDED BY THE ISSUERS IN THE SUB-SAMPLE



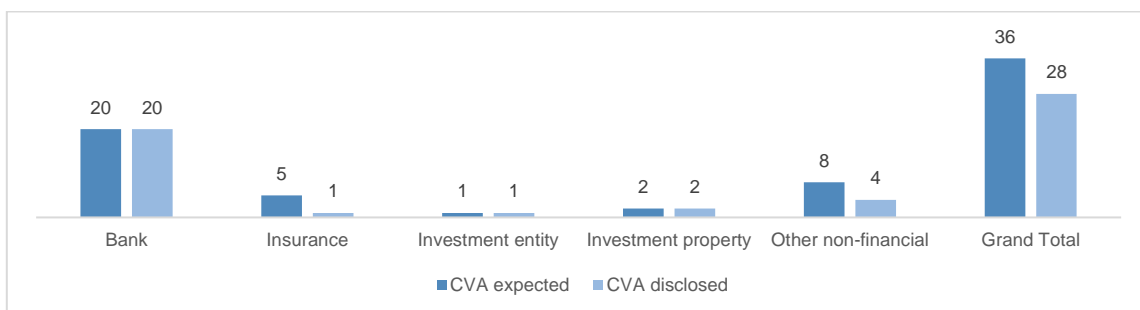
97. A variety of practices were observed on the location of CVA, DVA and FVA disclosures. While the majority of issuers presented information in the financial statements, other issuers presented the disclosures both in the financial statements and the management report (mainly CVA and DVA) and others only in the management report (mainly DVA and FVA). In a few cases, information was available only in other types of communications, such as presentation of the yearly financial results, in particular disclosures of the quantitative impact of these adjustments.

Disclosures on CVA

98. Information on CVA (or combined information on derivative valuation adjustments including CVA), was provided by 78% of the sub-sample. However, the nature and extent of those disclosures varied.

99. Notably, 22% of the sub-sample, which would have been expected to disclose information on CVA, did not provide such disclosures. These issuers were mainly insurance undertakings and non-financial institutions. In some cases, it could be understood from the available information that the risk management of the issuers included collateralization of their derivatives exposures which enabled them to mitigate their counterparty risk.

FIGURE 8: NUMBER OF ISSUERS DISCLOSING INFORMATION ON CVA (QUALITATIVE OR QUANTITATIVE) COMPARED TO NUMBER OF ISSUERS THAT WERE EXPECTED TO DISCLOSE, BY TYPE OF ISSUER



100. Almost half of the issuers which provided CVA information, disclosed both quantitative and qualitative information: these issuers were all banks. Only one non-financial entity (investment property) provided quantitative information.

101. Regarding the type of quantitative information disclosed, the vast majority of issuers that provided such disclosures indicated the impact on the income statement of the CVA adjustment. In almost half of the cases, this information was provided either net or in aggregate for all adjustments (CVA, DVA and FVA) or at least together for CVA and DVA. It is noteworthy the practice of providing detailed quantitative data on CVA, disaggregating it by counterparty and by related credit rating, with comparative figures.
102. The level of qualitative information provided varied from issuer to issuer. While non-financial undertakings mainly only referred to the existence of the CVA and/or provided a high-level explanation of what the CVA is, the level of information provided by financial institutions was variable. They ranged from general explanations of CVA to more developed disclosures on methodologies and inputs applied. This information was generally provided as part of the accounting policy section of the financial statements.
103. 30% of the issuers disclosing information on CVA provided no information on the methodology used for determining the exposures in the CVA calculation. When disclosed (by banks exclusively), the methodology applied in most cases was a standard practice consisting in the Expected Future Exposure Approach¹⁸, using generally complex models. However, in the other cases, references were sometimes made to the use of the Current Exposure Approach, the “mark to market + add-on” method, or a combination of different methodologies, without any further detail on the scope and volume concerned by these more simplified approaches.
104. As part of the methodology description, one third of the banks indicated explicitly that they took into account the general or specific wrong-way risk¹⁹ in their calculations of CVA. 17% of the issuers in the sub-sample disclosed information on any refinements or changes to the methodology to determine CVA.
105. Furthermore, with respect to the treatment of specific counterparties or exposures in the CVA calculation, mainly non-financial institutions – disclosed that they did not apply CVA calculation to derivative exposures settled through central clearing houses or subject to collateralisation.
106. 64% of the issuers in the sub-sample, including one fifth of non-financial undertakings, disclosed information on the inputs used in the calculation of the probability of default. These inputs were either market or historical data.
107. Almost all banks made reference to the use of market observable data as inputs for calculations of CVA, firstly CDS spread, curve, index, but also debt credit spread. These banks also referred to the use of rating-based, internal credit-rating data, or historical default information, or a combination of those historical and market data, where considered appropriate, for example, depending on the observability and relevance of the available data.

¹⁸ Expected Future Exposure Approach requires simulating the market variables driving a derivative's fair value over its lifetime, by revaluing the derivative for each simulated market scenario. The resulting exposure profiles are used to determine a CVA using counterparty PDs (DVA using the own PDs). On the contrary, Current Exposure Approach simplifies the calculation by basing the CVA/DVA calculation on the current market value of the derivative without simulating different possible future scenarios or outcomes.

¹⁹ Wrong way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

108. In some cases, the reference to inputs was only a generic reference to the use of observable market data. It was noted that none of the insurance companies in the sample for which derivative exposures were material provided information on the accounting or calculation of CVA, nor the inputs and methodologies used.

Disclosures on DVA and FVA

109. In comparison with CVA, less issuers in the sub-sample disclosed DVA and FVA information. 42% of the issuers in the sub-sample provided both quantitative and qualitative information on DVA and 19% for FVA .

110. 47% of the issuers in the sub-sample provided no disclosures on the methodology for DVA or FVA. A few issuers in the sub-sample (3% for DVA and 11% for FVA) provided information on any refinements or changes made to the methodology applied. The issuers disclosing information on methodology have, in most cases, adopted the Expected Future Exposure approach. For FVA, internally developed methodologies were also disclosed.

111. Finally, information on the inputs used to calculate DVA was disclosed by 58% of the issuers in the sub-sample, while only 19% of the issuers in the sub-sample disclosed input information for FVA. Inputs disclosed on DVA, similar to CVA, included CDS curve, or CDS index, credit-rating and historical default information and current debt credit spreads or a combination of those inputs. For FVA internal treasury rates were also used to estimate the market cost of funding

Conclusions for issuers

112. The comparability and relevance of information on CVA, DVA and FVA is limited by the lack of qualitative explanations that illustrate the drivers underlying the quantitative impacts presented. The quantitative impact of these adjustments is often presented as an aggregated amount which impairs the users' ability to understand the contribution of each of these adjustments to the derivative exposures of issuers and to make meaningful comparisons across different issuers. Therefore, ESMA encourages issuers to explain the rationale and key determinants of these adjustments as well as to separately present information relating to each of them, when they are material.

113. Regarding the inputs used to calculate these adjustments, ESMA highlights that IFRS 13 requires issuers to maximise the use of observable inputs and to take the market participant's view in assessing fair value. This implies that the selection of inputs for the calculation of CVA, DVA and FVA should only make use of unobservable inputs when observable inputs are not available to be consistent with the Standard. Historical information and entity-specific inputs are not in line with IFRS 13 unless there is evidence that they are consistent with market participants' views.

114. ESMA also believes that disclosures on the methodology used to calculate CVA, DVA and FVA are particularly important, when these elements have a significant impact. While simplified methodologies (e.g. current exposures, or add-on approach) may be a sufficient proxy for some issuers (e.g. non-financial institutions with limited derivative exposures), they should be used with more caution in the financial sector. Due to constant market developments, new adjustments on the fair value calculations of derivatives are emerging and being priced into transactions. ESMA therefore, recommends that concerned issuers closely monitor market development and ensure that their valuation reflects the price that would be paid or received to transfer an asset or assume a liability as required by IFRS 13.

Furthermore, where applicable, issuers should disclose in the financial statements the changes or refinement made in such calculations.

115. Finally, ESMA notes that the location of the information is diverse. ESMA acknowledges that the IFRS 13 disclosures on CVA, DVA and FVA may interact with the risk disclosures required by IFRS 7 for financial instruments. ESMA urges those issuers which present information on CVA, DVA and FVA as part of the required risk disclosures in the management commentary or risk report, to ensure that such information is clearly and specifically cross-referenced in the financial statements as required by IFRS 7 (paragraph B6).

Conclusions for the IASB

116. The guidance in IFRS 13 is principle-based. By fulfilling the disclosure objectives and requirements in IFRS 13 issuers should be able to provide relevant and understandable information on CVA, DVA and FVA.

117. ESMA acknowledges that market practice has evolved towards the explicit use of these (and other) adjustments as part of the fair value estimate of derivative positions. Therefore, ESMA would suggest that the IASB continue to monitor further developments in this area.

5.5 Other evidence from enforcement activities

118. Other critical areas of the application of IFRS 13 where enforcers have taken actions are reported in the table here below with examples of the issues encountered.

TABLE 1: OTHER ISSUES IDENTIFIED IN THE COURSE OF ENFORCEMENT ACTIONS BETWEEN 2013 AND 2015

Enforcement Topic	Example of issue encountered
Highest and best use	In estimating the fair value of abandoned property the issuer used the cost approach, however the current use (i.e. no use of the property) was inconsistent with the highest and best use of the property when considering the market participant's perspective and therefore a different technique should have been used to estimate fair value.
Assessment of whether an observable or unobservable input must be used	In measuring fixed rate loans, the issuer used a discount rate that was significantly lower than the observable interest rate on newly issued loans with same duration and credit risk ²⁰ .
Use of an incorrect valuation technique and use of outdated data	<p>In applying the multiple valuation technique, the issuer considered old transaction multiples and did not take into account current market and entity conditions.</p> <p>Another issuer used an average market price based on a period of more than 30 days for measuring the fair value of own shares given as a part of consideration in a business combination, while the market was active and provided a reliable measurement basis at the acquisition date.</p>

²⁰ 18th Extract from the EECS's Database of Enforcement: Decision ref EECS/0215-08 – Fair value measurement for fixed-rate loans

Appendix: Examples of disclosures

Example 1: For Level 2 and Level 3 recurring fair value measurements, disclosure of the amount of fair value, the valuation techniques and the inputs used

Millions of euros

	Fair values calculated using internal models at 31/12/15		Valuation techniques	Main assumptions
	Level 2	Level 3		
ASSETS:	156,174	2,481		
Financial assets held for trading	80,488	950		
Loans and advances to credit institutions	2,293	-	Present Value Method	Yield curves, FX market prices
Loans and advances to customers ^a	6,081	-	Present Value Method	Yield curves, FX market prices
Debt and equity instruments	650	43	Present Value Method	Yield curves, HPI, FX market prices
Trading derivatives	71,464	907		
Swaps	52,904	54	Present Value Method, Gaussian Copula ^b	Yield curves, FX market prices, Basis, Liquidity
Exchange rate options	1,005	-	Black-Scholes Model	Yield curves, Volatility surfaces, FX market prices, Liquidity
Interest rate options	8,276	619	Black's Model, Heath-Jarrow-Morton Model	Yield curves, Volatility surfaces, FX market prices, Liquidity, Correlation
Interest rate futures	84	-	Present Value Method	Yield curves, FX market prices
Index and securities options	1,585	120	Black-Scholes Model	Yield curves, Volatility surfaces, FX & EQ market prices, Dividends, Correlation, Liquidity, HPI
Other	7,610	114	Present Value Method, Monte Carlo simulation and other	Yield curves, Volatility surfaces, FX market prices, Other
Hedging derivatives	7,438	18		
Swaps	6,437	18	Present Value Method	FX market prices, Yield curves, Basis
Exchange rate options	-	-	Black-Scholes Model	FX market prices, Yield curves, Volatility surfaces
Interest rate options	19	-	Black's Model	FX market prices, Yield curves, Volatility surfaces
Other	982	-	N/A	N/A
Other financial assets at fair value through profit or loss	41,285	514		
Loans and advances to credit institutions	26,403	-	Present Value Method	FX market prices, Yield curves
Loans and advances to customers ^c	14,213	81	Present Value Method	FX market prices, Yield curves, HPI
Debt and equity instruments	669	433	Present Value Method	FX market prices, Yield curves
Available-for-sale financial assets	26,963	999		
Debt and equity instruments	26,963	999	Present Value Method	FX market prices, Yield curves
LIABILITIES:	151,768	324		
Financial liabilities held for trading	87,858	302		
Deposits from central banks	2,178	-	Present Value Method	FX market prices, Yield curves
Deposits from credit institutions	76	-	Present Value Method	FX market prices, Yield curves
Customer deposits	9,187	-	Present Value Method	FX market prices, Yield curves

Source: Banco Santander 2015 Auditor's report and Annual Accounts, page 30 (extracts).

Example 2: Sensitivity analysis for Level 3 measurements – Investment property

The below tables illustrate the impact of changes in key unobservable inputs on the market value of investment and development property.

Sensitivity analysis – income capitalisation method

	2015		2014	
	Estimated Rental Value	Equivalent Yield	Estimated Rental Value	Equivalent Yield
	10% increase or decrease £m	25 basis point contraction or expansion £m	10% increase or decrease £m	25 basis point contraction or expansion £m
Income capitalisation				
Covent Garden	204.6/(199.5)	171.6/(148.3)	134.2/(129.7)	104.0/(91.3)
Earls Court Properties	1.9/(1.9)	1.2/(1.0)	1.2/(1.2)	0.8/(0.7)
Other	0.4/(0.4)	0.2/(0.2)	0.5/(0.5)	0.3/(0.3)

The above inputs are interdependent. For example an increase in estimated rental value will lead to a contraction in equivalent yield, assuming other inputs remain unchanged.

Sensitivity analysis – residual development method

	2015	Represented 2014 ¹
	Construction costs including site specific costs per sq ft	Construction costs including site specific costs per sq ft
	10% increase or decrease £m	10% increase or decrease £m
Residual development method		
Covent Garden	(10.6)/12.6	(10.4)/10.1
Earls Court Properties ¹	(220.7)/222.1	(138.2)/134.5
Venues ¹	(4.6)/4.7	(5.1)/5.8

¹ The comparative period has been re-presented to reflect the transfer of Maclise Road from the Earls Court Properties segment to the Venues segment.

Sensitivity analysis – discounted cash flow approach

	2015	2014
	Pre-tax discount rate	Pre-tax discount rate
	10% increase or decrease £m	10% increase or decrease £m
Discounted cash flow approach		
Earls Court Properties	(0.2)/0.2	–
Venues	(28.5)/35.5	(21.3)/26.4

Source: Capital and Counties Properties Plc 2015 Annual report & accounts, page 117 (extracts)

Example 3: Description of valuation techniques and sensitivity analysis for Level 3 measurements – Financial instruments

Valuation techniques and sensitivity analysis

Sensitivity analysis is performed on products with significant unobservable inputs (Level 3) to generate a range of reasonably possible alternative valuations. The sensitivity methodologies applied take account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historical data and the impact of using alternative models.

Sensitivities are dynamically calculated on a monthly basis. The calculation is based on range or spread data of a reliable reference source or a scenario based on relevant market analysis alongside the impact of using alternative models. Sensitivities are calculated without reflecting the impact of any diversification in the portfolio.

The valuation techniques used for the material products within Levels 2 and 3, and observability and sensitivity analysis for products within Level 3, are described below.

Credit derivatives

Description: These are derivatives linked to the credit spread of a referenced entity, index or basket of referenced entities or a pool of referenced assets via securitisation. This category includes single name and index CDS, asset backed CDS, synthetic CDOs, and Nth-to-default basket swaps.

Valuation: CDS are valued using a market standard model that incorporates the credit curve as its principal input. Credit spreads are observed directly from broker data, third party vendors or priced to proxies. Where credit spreads are unobservable, they are determined with reference to recent transactions or proxied from bond spreads on observable trades of the same issuer or other similar entities. Synthetic CDOs are valued using a model that calculates fair value based on credit spreads, recovery rates, correlations and interest rates, and is calibrated to the index tranche market.

Observability: CDS contracts referencing entities that are not actively traded are considered unobservable. The correlation input to synthetic CDO valuation is considered unobservable as it is proxied from the observable index tranche market. Where an asset backed credit derivative does not have an observable market price and the valuation is determined using a model, the instrument is considered unobservable.

Level 3 sensitivity: The sensitivity of valuations of the illiquid CDS portfolio is determined by applying a shift to each spread curve. The shift is based on the average range of pricing observed in the market for similar CDS. Synthetic CDO sensitivity is calculated using correlation levels derived from the range of contributors to a consensus bespoke service.

Source: Barclays 2015 Annual report, page 282-283 (extracts)

Example 4: Presentation of key inputs for Level 3 measurements – Investment property

As at December 31, 2015, independent experts have appraised 97% of Unibail-Rodamco's portfolio.

As the appraisers noted no meaningful impact of the terrorist attacks in Paris on the Group's assets during this valuation round, the December 2015 valuations have not been impacted.

The outstanding balances of deferred lease incentives and key monies amortised over the firm term of the lease and deducted from the appraisal value represented €73.2 Mn.

The following tables provide a number of quantitative elements used by the appraisers to assess the fair valuation of the Group's assets.

Shopping Centres

All Shopping Centres are valued using the discounted cash flow and/or yield methodologies.

Shopping Centres – December 31, 2015		Net initial yield	Rent in € per sqm ⁽¹⁾	Discount Rate ⁽²⁾	Exit yield ⁽³⁾	CAGR of NRI ⁽⁴⁾
France	Max	8.7%	905	13.0%	9.5%	8.8%
	Min	3.6%	85	5.3%	4.0%	0.2%
	Weighted average	4.3%	487	5.9%	4.5%	4.9%
Central Europe ⁽⁵⁾	Max	8.8%	535	11.5%	9.5%	4.9%
	Min	4.9%	116	6.8%	5.1%	2.2%
	Weighted average	5.2%	369	7.0%	5.5%	2.7%
Nordic	Max	9.8%	531	9.8%	7.8%	5.5%
	Min	4.1%	114	6.7%	4.5%	2.2%
	Weighted average	4.6%	358	7.2%	4.8%	4.5%
Spain	Max	8.4%	747	11.0%	7.8%	5.2%
	Min	4.6%	100	7.5%	4.8%	1.4%
	Weighted average	5.1%	274	8.2%	5.2%	3.4%
Germany ⁽⁵⁾	Max	7.2%	399	8.0%	6.9%	4.5%
	Min	4.3%	238	6.4%	4.2%	2.2%
	Weighted average	4.8%	293	6.8%	4.8%	3.0%
Austria ⁽⁵⁾	Max	4.5%	367	6.4%	4.5%	2.8%
	Min	4.4%	345	6.3%	4.5%	2.6%
	Weighted average	4.5%	356	6.3%	4.5%	2.7%
The Netherlands	Max	12.4%	412	9.1%	9.0%	4.3%
	Min	4.5%	131	6.0%	4.4%	-1.8%
	Weighted average	5.0%	252	6.5%	5.0%	3.1%

Net initial yield, discount rate and exit yield weighted by gross market values.

(1) Average annual rent (minimum guaranteed rent + sales based rent) per asset per m².

(2) Rate used to calculate the net present value of future cash flows.

(3) Rate used to capitalise the exit rent to determine the exit value of an asset.

(4) Compounded Annual Growth Rate of net rental income determined by the appraiser (between 6 and 10 years depending on duration of DCF model used).

(5) Aupark (Bratislava) was transferred from Austria to Central Europe in January 2015. German assets are now presented separately.

Offices

Appraisers value the Group's Offices using the discounted cash flow and yield methodologies.

Offices – December 31, 2015		Net initial yield on occupied space	Rent in € per sqm ⁽¹⁾	Discount Rate ⁽²⁾	Exit yield ⁽³⁾	CAGR of NRI ⁽⁴⁾
France	Max	11.9%	484	9.8%	8.3%	24.5%
	Min	4.0%	104	5.0%	4.3%	-2.6%
	Weighted average	5.9%	370	6.1%	5.2%	3.1%
Nordic	Max	9.0%	248	9.0%	7.9%	3.9%
	Min	5.1%	68	7.1%	5.5%	1.6%
	Weighted average	7.0%	195	7.9%	6.6%	2.8%
The Netherlands	Max	15.5%	52	13.8%	9.8%	9.4%
	Min	n.m	n.m	6.6%	5.4%	n.m
	Weighted average	8.1%	47	10.5%	8.1%	9.3%
Germany	Max	7.7%	535	8.5%	7.5%	7.6%
	Min	4.9%	53	6.5%	4.5%	1.4%
	Weighted average	5.9%	165	7.9%	6.3%	2.9%
Austria	Max	6.9%	126	7.6%	7.0%	2.7%
	Min	6.4%	120	7.2%	6.5%	2.0%
	Weighted average	6.7%	123	7.4%	6.8%	2.4%

Net initial yield, discount rate and exit yield weighted by gross market values. Central Europe region only encompasses one asset (excluding shares in Zlote Tarasy offices, Lumen and Skylight) and is therefore not displayed. Vacant assets and assets under restructuring are not included in this table. Asset considered at bid value are not displayed in this table.

(1) Average annual rent (minimum guaranteed rent) per asset per m². The computation takes into account the areas allocated to company restaurants.

(2) Rate used to calculate the net present value of future cash flows.

(3) Rate used to capitalise the exit rent to determine the exit value of an asset.

(4) Compounded Annual Growth Rate of net rental income determined by the appraiser (between 3 and 10 years depending on duration of DCF model used).

Source: Unibail 2015 Annual Report, pages 180-181 (extracts).

Example 5: Disclosures on valuation adjustments on the fair value of derivatives – Qualitative information

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. A breakdown of valuation adjustments is provided in Capital and risk management: Credit derivatives on page 230.

Credit valuation adjustments (CVA)

CVA represent an estimate of the adjustment to fair value that a market participant would make to incorporate the counterparty credit risk inherent in derivative exposures. CVA is actively managed by a credit and market risk hedging process, and therefore movements in CVA are partially offset by trading revenue on the hedges.

The CVA is calculated on a portfolio basis reflecting an estimate of the amount a third party would charge to assume the credit risk.

Where a positive exposure exists to a counterparty that is considered to be close to default, the CVA is calculated by applying expected losses to the current level of exposure. Otherwise, expected losses are applied to estimated potential future positive exposures which are modelled to reflect the volatility of the market factors which drive the exposures and the correlation between those factors.

Expected losses are determined from market implied probabilities of default and internally assessed recovery levels. The probability of default is calculated with reference to observable credit spreads and observable recovery levels. For counterparties where observable data do not exist, the probability of default is determined from the credit spreads and recovery levels of similarly rated entities.

Collateral held under a credit support agreement is factored into the CVA calculation. In such cases where RBS holds collateral against counterparty exposures, CVA is held to the extent that residual risk remains.

Source: Royal Bank of Scotland 2015 Auditor's report and Annual Accounts, page 298 (extracts).

Example 6: Disclosures on valuation adjustments on the fair value of derivatives – Quantitative information

Valuation reserves

When valuing financial instruments in the trading book, adjustments are made to mid-market valuations to cover bid-offer spread, liquidity and credit risk. The following table shows credit valuation adjustments (CVA) and other valuation reserves. CVA represents an estimate of the adjustment to fair value that a market participant would make to incorporate the risk inherent in derivative exposures. For discussion of CVA methodology, refer to Financial instruments - valuation on page 297.

	2015 £m	2014 £m
Credit valuation adjustments (CVA)	774	1,414
Other valuation reserves		
- bid-offer	304	398
- funding valuation adjustment (FVA)	752	718
- product and deal specific	660	657
	1,716	1,773
Valuation reserves	2,490	3,187

The table below analyses CVA relating to counterparties by rating and sector.

	2015 £m	2014 £m
Ratings		
AAA	37	82
AA to AA+	66	67
A to AA-	49	78
BBB- to A-	293	401
Non-investment grade and unrated	329	786
	774	1,414
Counterparty		
Banks	18	32
Other financial institutions	126	250
Corporate	470	938
Government	160	194
	774	1,414

Source: Royal Bank of Scotland 2015 Auditor's report and Accounts, page 229 (extracts).