From: Bob Hymas
To: UKFRS
Subject: FRED 54 - Response from PRAG
Date: 30 April 2014 18:04:01

Susanne Pust Shah
The Financial Reporting Council
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Dear Susanne

FRED 54 – Draft Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* Basic Financial Instruments

The Pensions Research Accountants Group (PRAG) is an independent research and discussion group for the development and exchange of ideas in the pension field. Its efforts are concentrated mainly on the areas of reporting and accounting by pension schemes, but it has also produced reports on other matters when appropriate. Members work for pension funds, administrators, audit firms and other pension related professions.

PRAG has recently issued the Exposure Draft (ED) on the revision of the pension Statement of Recommended Practice (SORP) which reflects, amongst other things, the introduction of FRS 102 into UK GAAP. PRAG has noted in the ED that the fair value hierarchy required by FRS 102 is not consistent with the fair value hierarchy under IFRS. This inconsistency has a number of undesirable consequences as described below.

- investment accounting providers will have to develop new reporting systems to deliver fair value hierarchy analyses on the FRS 102 basis rather than being able to use existing systems already configured to deliver the fair value hierarchy required under IFRS. This will increase the costs of complying with FRS 102.
- readers of financial statements may be confused because they do not appreciate the differences between FRS 102 and IFRS. In particular, the FRS 102 fair value hierarchy allocates any investment that uses a valuation technique into the lowest category. This may be perceived by readers of the financial statements as negative because the lowest category, or level under IFRS, is reserved for typically highly illiquid and opaque investments that use non-observable inputs. This could be associated with ‘toxic’ investments. Under FRS 102 investment properties, OTC derivatives and most bonds would be allocated to the lowest level together with genuinely hard to value investments such as private equity. This may mislead readers of the financial statements and cause unnecessary concern, particularly amongst trustees and pension scheme members.
- In order to address the concern raised in the preceding bullet point the revised pension SORP and other revised SORPs (IMA and AIC) have adapted FRS 102’s requirements to more closely resemble those required under IFRS. This solution adds to the complexity of financial reporting for entities covered by these SORPs and introduces further differences in reporting compared to entities that adopted FRS 102 on an un-amended basis.

PRAG understands from its discussions with the FRC during the SORP revision process that the FRC is minded not to consider amending FRS 102 to align the fair value hierarchy with IFRS until at least 2018. PRAG requests that the FRC re-consider this approach and take the opportunity of the amendments being proposed by FRED 54 to also amend FRS 102 to align its fair value hierarchy with IFRS. This amendment would meet two of the criteria set out in FRED 54 for the amendments it is proposing, namely to align FRS 102 more closely with IFRS and reduce the cost of compliance with FRS 102. It would also remove the need to introduce short term changes to pension scheme financial disclosures and simplify the approach being taken in the revised SORPs.

Yours sincerely

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Pensions Research Accountants Group
