Exposure Draft

Financial Reporting Council

November 2015

FRED 62

Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Fair value hierarchy disclosures

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

Summary

(i) With effect from 1 January 2015 the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with five Financial Reporting Standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*;

(d) FRS 103 *Insurance Contracts*; and

(e) FRS 104 *Interim Financial Reporting*.

The FRC has also issued FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* to support the implementation of the new micro-entities regime.

This FRED proposes limited amendments to FRS 102.

(ii) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

(iii) In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Draft amendments to FRS 102

(iv) This FRED proposes limited amendments to FRS 102, which are relevant only to financial institutions and retirement benefit plans, and relate to the disclosure of financial instruments in an analysis based on the fair value hierarchy. These proposals are intended to simplify the preparation of disclosures about financial instruments for the entities affected, whilst increasing the consistency with disclosures required by EU-adopted IFRS that users of the financial statements will often be familiar with.

Invitation to comment

1 The FRC is requesting comments on FRED 62 by 31 January 2016. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft standard. In particular, comments are sought in relation to the questions below.

> **Question 1**
>
> Do you agree with the amendments proposed to FRS 102? If not, why not?
>
> **Question 2**
>
> Do you agree with the proposed effective date for these amendments? If not, what alternative would you propose?
>
> **Question 3**
>
> In relation to the Consultation Stage Impact Assessment do you have any comments on the costs and benefits identified? Please provide evidence to support your views of the quantifiable costs or benefits of these proposals.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 12.

[Draft] Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

[Draft] Amendments to Section 1 *Scope*

1 The following paragraph sets out the [draft] amendments to Section 1 *Scope* (inserted text is underlined).

2 Paragraph 1.16 is inserted as follows:

<u>1.16 In [March 2016] amendments were made to paragraphs 34.22 and 34.42 of this FRS, revising the disclosure requirements for financial institutions and retirement benefit plans. An entity shall apply these amendments for accounting periods beginning on or after 1 January 2017. Early application is permitted. If an entity applies these amendments before 1 January 2017 it shall disclose that fact.</u>

[Draft] Amendments to Section 34 *Specialised Activities*

3 The following paragraphs set out the [draft] amendments to Section 34 *Specialised Activities* (deleted text is struck through, inserted text is underlined).

4 Paragraph 34.22 is amended as follows:

34.22 For financial instruments held at **fair value** in the statement of financial position, a financial institution shall disclose for each class of financial instrument, an analysis of the level in the following fair value hierarchy ~~(as set out in paragraph 11.27)~~ into which the fair value measurements have been categorised. A fair value measurement is categorised in its entirety on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

- Level 1: The unadjusted quoted price in an **active market** for identical **assets** or **liabilities** that the entity can access at the measurement date.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable (ie developed using market data) for the asset or liability, either directly or indirectly.
- Level 3: Inputs are unobservable (ie for which market data is unavailable) for the asset or liability.

5 In paragraph 34.27 ‘assets’ will no longer be shown in bold type.

6 Paragraph 34.42 is amended as follows:

34.42 For financial instruments held at fair value in the statement of net assets available for benefits, a retirement benefit plan shall disclose for each class of financial instrument, an analysis of the level in the following fair value hierarchy ~~(as set out in paragraph 11.27)~~ into which the fair value measurements are categorised. A fair value measurement is categorised in its entirety on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

- Level 1: The unadjusted quoted price in an **active market** for identical assets or liabilities that the entity can access at the measurement date.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable (ie developed using market data) for the asset or liability, either directly or indirectly.
- Level 3: Inputs are unobservable (ie for which market data is unavailable) for the asset or liability.

The Accounting Council's Advice to the FRC to issue FRED 62 *Draft amendments to FRS 102 – Fair value hierarchy disclosures*

Introduction

1 This report provides an overview of the main issues that have been considered by the Accounting Council in advising the Financial Reporting Council (FRC) to issue FRED 62 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Fair value hierarchy disclosures*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The *Foreword to Accounting Standards* sets out the application of accounting standards in the Republic of Ireland.

3 In accordance with the *FRC Codes and Standards: procedures*, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

(a) it is apparent that a significant group of stakeholders has not been adequately consulted;

(b) the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;

(c) insufficient consideration has been given to the timing or cost of implementation; or

(d) the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

4 The FRC has established the Accounting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

5 The Accounting Council is advising the FRC to issue FRED 62 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Fair value hierarchy disclosures.*

6 The Accounting Council advises that these proposals will reduce the costs of complying with FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* for financial institutions and retirement benefit plans, whilst increasing the consistency with disclosures required by EU-adopted IFRS that users of the financial statements will often be familiar with.

7 When these draft amendments are finalised, the Accounting Council's Advice to the FRC in respect of these amendments will be added into FRS 102.

Background

8 The FRC has received feedback that amending the fair value disclosure requirements applicable to financial institutions and retirement benefit plans will reduce the costs of complying with FRS 102, and allow these entities to provide information to users that is more consistent with EU-adopted IFRS. This should also make it easier for users to make comparisons between the financial statements of these entities and those applying EU-adopted IFRS.

Draft amendments to FRS 102

9 In developing its advice to the FRC, the Accounting Council was guided by the overriding objective to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

10 In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

11 After FRS 102 was issued the FRC received feedback, for example in response to FRED 54 *Draft amendments to FRS 102 – Basic financial instruments*, from the representative bodies of some financial institutions and retirement benefit plans suggesting that the disclosure requirements for these entities, relating to financial instruments held at fair value, could be made more cost-effective, whilst increasing their usefulness to users of the financial statements. For those users familiar with the IFRS disclosures, the consistency of disclosure with IFRS may also reduce costs or effort of comparison and the possibility of confusion. No amendments were made at the time of finalising the amendments resulting from FRED 54, because this issue was outside the scope of that consultation. However, the FRC agreed to consult on this issue as part of the triennial review of FRS 102.

12 The FRC has decided to postpone the triennial review of FRS 102 by one year to allow more time for implementation experience to develop and provide a three-year stable platform for small entities applying FRS 102 for the first time from 1 January 2016. As a result, to avoid postponing this issue for a year, the Accounting Council advises that an amendment to FRS 102 should be proposed to amend the disclosure requirements for financial institutions and retirement benefit plans. The proposed amendment will not affect any other entities applying FRS 102, and will not otherwise disrupt the three-year stable platform for small entities.

13 In advising that an amendment be made to FRS 102, the Accounting Council carefully considered how to balance the desire for stability in FRS 102 with requests for improvements that are expected to lead to greater efficiency. The Accounting Council concluded that as the proposed amendment affected only a small number of entities (and that stability would be retained for the remainder) and relates to streamlining disclosures it was appropriate to advise a change in FRS 102 outside the triennial review.

14 The Accounting Council notes that currently paragraphs 34.22 and 34.42 of FRS 102 require financial institutions and retirement benefit plans, respectively, to provide disclosures about financial instruments held at fair value analysed by the level of the fair value hierarchy in paragraph 11.27 of FRS 102. This hierarchy is not the same as the hierarchy set out in IFRS 13 *Fair Value Measurement*, and therefore the disclosures provided by a financial institution or retirement benefit plan applying FRS 102 will not be directly comparable to those provided by an entity applying EU-adopted IFRS.

The SORPs for Authorised Funds, Investment Trust Companies and Pension Schemes require, or permit, additional disclosure from entities within their scope in order to improve this comparability. The Accounting Council also notes that some financial institutions previously applied FRS 29 *Financial instruments: Disclosures*, which required disclosure according to a fair value hierarchy that is consistent with IFRS 13, and therefore for these entities FRS 102 had introduced a departure from IFRS.

15 In order to make FRS 102 more cost-effective, the Accounting Council advises that financial institutions and retirement benefit plans should categorise fair value measurements into levels consistent with the fair value hierarchy set out in IFRS 13. This is consistent with the aims for developing and maintaining FRS 102.

Impact on other entities applying FRS 102

16 Other than financial institutions and retirement benefit plans, entities applying FRS 102 are not required to provide disclosures in accordance with the fair value hierarchy as paragraph 11.43 requires information about the basis for determining fair value, but does not require this to be categorised according to the fair value hierarchy in paragraph 11.27. Therefore the proposed amendments will not impact on any other entities applying FRS 102.

17 The Accounting Council notes, however, that this leads to an inconsistency within FRS 102, whereby the hierarchy described in paragraph 11.27 for the purposes of determining a process for estimating fair values will no longer be consistent with the hierarchy used for disclosure purposes in Section 34 *Specialised Activities*. Therefore the Accounting Council advises that, as part of the first triennial review of FRS 102, consideration should be given to revising paragraph 11.27.

Effective date

18 The Accounting Council advises that the amendments to FRS 102 set out in this FRED should be effective for accounting periods beginning on or after 1 January 2017, with early adoption permitted.

19 Any amendments to FRS 102 arising from this FRED would not be finalised until after 1 January 2016 and therefore the proposed effective date is 1 January 2017 in order to avoid mandatory application prior to the amendments being finalised. However, the Accounting Council notes that, as the proposals relate to disclosure only, and early application is permitted, an entity may be able to apply the proposed amendments to financial statements for periods ending on 31 December 2015 if those financial statements have not been approved by the time that the final amendments are issued.

20 The Accounting Council also notes that amendments to the relevant SORPs will not be necessary before any changes to FRS 102 can take effect because a change in accounting standards after a SORP has been issued means that any inconsistent provisions of a SORP cease to have effect. The relevant SORPs would, however, require amendment in due course.

Consultation stage impact assessment

Introduction

1 The Financial Reporting Council (FRC) is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

Draft amendments to FRS 102

2 The draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* are intended to reduce the potential cost of compliance with FRS 102, whilst increasing the consistency with disclosures required by EU-adopted IFRS that users of the financial statements will often be familiar with.

3 The draft amendments may impact differently on different entities:

(a) entities that are neither financial institutions nor retirement benefit plans will be unaffected by the proposals – this is the vast majority of entities applying FRS 102;

(b) entities that are financial institutions or retirement benefit plans and are within the scope of a SORP; and

(c) other financial institutions.

4 Financial institutions and retirement benefit plans within the scope of a SORP are currently required, or permitted, by the relevant SORP to provide disclosures about fair value in a way that allows them to both comply with FRS 102 and provide information that is similar to that required by IFRS. Some of these entities will have previously applied FRS 29 *Financial instruments: Disclosures*, which was also consistent with IFRS. Feedback received by the FRC on behalf of preparers suggests that the draft amendments will lead to cost savings as additional resources or additional systems will no longer be necessary to produce the FRS 102 disclosures and the IFRS disclosures. For those previously applying FRS 29 the costs, in relation to this disclosure, will not be increased by the implementation of FRS 102. In addition, increased comparability with entities applying IFRS will be useful for users already familiar with IFRS disclosures and aid comparison of the financial statements of financial institutions to those of entities applying IFRS.

5 Some financial institutions are not within the scope of a SORP, and are unlikely to have applied FRS 29 in the past. For these entities the disclosures required by FRS 102 were likely to be new. For some of these entities, closer alignment with IFRS will also be beneficial to allow greater comparison between entities, although the cost savings may be less significant. With a proposed effective date of 1 January 2017 for the amendments, these entities will have time to prepare for the change.

Conclusion

6 The FRC believes that the draft amendments to FRS 102 will have a positive impact on financial reporting and reduce the costs of compliance. This FRED asks stakeholders for their views on the cost and benefits identified and evidence to support the quantifiable costs and benefits identified. This feedback will be taken into account in finalising the impact assessment.

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Comments should be despatched so as to be received no later than 31 January 2016.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

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