Exposure Draft

Financial Reporting Council

July 2019

FRED 72

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

Interest rate benchmark reform

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

Financial Reporting Council

July 2019

FRED 72

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

Interest rate benchmark reform

Contents

Overview

(i) 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.

Draft amendments to FRS 102

(ii) Interest rate benchmarks such as the London Interbank Offered Rate (LIBOR) are being reformed, and it is anticipated that LIBOR will not be available after 2021. The IASB noted the increasing uncertainty about the long-term viability of some interest rate benchmarks and decided to add a project to its agenda to consider the financial reporting implications of the reform. The IASB issued ED/2019/1 *Interest Rate Benchmark Reform – Proposed amendments to IFRS 9 and IAS 39* in May 2019. This specifically considers the hedge accounting requirements of IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*, and proposes amendments to specific hedge accounting requirements to provide relief during the period of uncertainty before the interest rate benchmark is replaced.

(iii) Interest rate benchmark reform will affect some entities applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The hedge accounting requirements of FRS 102, set out in Section 12 *Other Financial Instruments Issues*, are based on IFRS 9, and FRS 102 also permits entities an accounting policy choice to apply the recognition and measurement requirements of IFRS 9 or IAS 39. Therefore, the FRC has considered how the IASB's proposals might be reflected in FRS 102 in order that the proposed relief is available to all entities, regardless of their accounting policy choice in relation to financial instruments.

(iv) This FRED proposes amendments to specific hedge accounting requirements in Section 12 *Other Financial Instruments Issues* to provide relief that will avoid unnecessary discontinuation of hedge accounting, during the period of uncertainty. Entities will apply those hedge accounting requirements assuming that the interest rate benchmark relevant to the hedge accounting is not altered as a result of interest rate benchmark reform.

(v) The proposals are based on ED/2019/1 and the finalisation of the amendments will take into account not only respondents' feedback to this FRED, but also any changes made by the IASB to its proposals as they are finalised.

(vi) It is proposed that the amendments are effective for accounting periods beginning on or after 1 January 2020, with early application permitted.

Invitation to comment

1 The FRC is requesting comments on FRED 72 by 20 September 2019. 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 proposed amendments to FRS 102? If not, why not?

Question 2

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.

2 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 13.

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 1.22 is inserted as follows:

1.22 In [month year] amendments were made to this FRS to insert paragraphs 12.25B to 12.25G and 12.30, and make other minor consequential amendments. These amendments are effective for accounting periods beginning on or after 1 January 2020. Early application is permitted. If an entity applies these amendments to an accounting period beginning before 1 January 2020 it shall disclose that fact, unless it is a small entity, in which case it is encouraged to disclose that fact.

Draft amendments to Section 11 *Basic Financial Instruments*

3 The following paragraphs set out the draft amendments to Section 11 *Basic Financial Instruments* (inserted text is underlined, deleted text is struck through).

4 Footnote 34 to paragraph 11.2(b) is amended as follows:

34 ~~Until IAS 39 is superseded by IFRS 9 *Financial Instruments*, an entity shall apply the version of IAS 39 that is in effect at the entity's reporting date, by reference to the IFRS publication titled *International Financial Reporting Standards IFRS Consolidated without early application*. When IAS 39 is superseded by IFRS 9, a~~An entity shall apply the version of IAS 39 that applied immediately prior to IFRS 9 superseding IAS 39, and the amendments made to IAS 39 by *Interest Rate Benchmark Reform* issued in [date]. A copy of that version will be retained for reference on the FRC website (www.frc.org.uk). Entities shall apply the so-called 'EU carve-out' of IAS 39', which amended paragraph 81A and related Application Guidance in IAS 39.

Draft amendments to Section 12
Other Financial Instruments Issues

5 The following paragraphs set out the draft amendments to Section 12 *Other Financial Instruments Issues* (inserted text is underlined, deleted text is struck through).

6 Footnote 39 to paragraph 12.2(b) is amended as follows:

39 ~~Until IAS 39 is superseded by IFRS 9 *Financial Instruments*, an entity shall apply the version of IAS 39 that is in effect at the entity's reporting date, by reference to the IFRS publication titled *International Financial Reporting Standards IFRS Consolidated without early application*. When IAS 39 is superseded by IFRS 9, a~~An entity shall apply the version of IAS 39 that applied immediately prior to IFRS 9 superseding IAS 39, and the amendments made to IAS 39 by *Interest Rate Benchmark Reform* issued in [date]. A copy of that version will be retained for reference on the FRC website (www.frc.org.uk). Entities shall apply the so-called 'EU carve-out' of IAS 39', which amended paragraph 81A and related Application Guidance in IAS 39.

7 Paragraphs 12.25B to 12.25G and the sub-heading before them are inserted as follows:

Temporary amendments to specific hedge accounting requirements

12.25B Paragraphs 12.25C to 12.25G only apply to hedging relationships of interest rate risk that are affected by interest rate benchmark reform. A hedging relationship is affected by interest rate benchmark reform if the reform gives rise to uncertainties about the timing and/or the amount of the interest rate benchmark-based cash flows of the hedged item and/or the hedging instrument.

12.25C If the hedged item is a highly probable forecast transaction (or a component thereof), an entity shall determine whether the forecast transaction is highly probable assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.

12.25D In applying the requirement in paragraph 12.25A to determine whether the hedged cash flows are no longer expected to occur, an entity shall assume that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.

12.25E In applying the requirement in paragraph 12.18A, an entity shall assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform.

12.25F For a hedge of a benchmark component of interest rate risk that is affected by interest rate benchmark reform, an entity shall apply the requirement in paragraph 12.16C(a) – that the changes in the cash flows or fair value attributable are a separately identifiable and reliably measurable specific risk or risks – only at the inception of the hedging relationship.

12.25G An entity shall cease applying paragraphs 12.25C to 12.25E when:

(a) the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows;

(b) the hedging relationship is discontinued; or

(c) when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

8 Paragraph 12.25B is renumbered as paragraph 12.25H.

9 Paragraph 12.30 is inserted as follows:

12.30 When an entity has taken advantage of the temporary amendments to specific hedge accounting requirements in paragraphs 12.25C to 12.25F, it shall disclose that fact. It shall also consider whether any further disclosure is necessary, for example in accordance with paragraphs 8.6 and 8.7.

Basis for Conclusions
FRED 72 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Interest rate benchmark reform*

This Basis for Conclusions accompanies, but is not part of, this Financial Reporting Exposure Draft and summarises the main issues considered by the Financial Reporting Council (FRC) in developing FRED 72 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Interest rate benchmark reform.

When these proposals are finalised, the Basis for Conclusions accompanying FRS 102 will be updated.

Objective

1 In developing financial reporting standards, the overriding objective of the FRC 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.

2 In achieving this objective, the FRC aims to provide succinct financial reporting standards that:

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

(b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;

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

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Interest rate benchmark reform

3 For the purpose of these proposed amendments, interest rate benchmark reform refers to the market-wide replacement of an existing interest rate benchmark with an alternative interest rate that results from the recommendations set out in the Financial Stability Board's July 2014 report *Reforming Major Interest Rate Benchmarks*.

4 Interest rate benchmarks such as the London Interbank Offered Rate (LIBOR) are being reformed, and it is anticipated that LIBOR will not be available after 2021. The IASB noted the increasing uncertainty about the long-term viability of some interest rate benchmarks and decided to add a project to its agenda to consider the financial reporting implications of the reform. The IASB issued ED/2019/1 *Interest Rate Benchmark Reform – Proposed amendments to IFRS 9 and IAS 39* in May 2019. This specifically considers the hedge accounting requirements of IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*, and proposes exceptions to specific hedge accounting requirements to provide relief during the period of uncertainty before the interest rate benchmark is replaced.

5 Interest rate benchmark reform will affect some entities applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The hedge accounting requirements of FRS 102, set out in Section 12 *Other Financial Instruments Issues*, are

based on IFRS 9, and FRS 102 also permits entities an accounting policy choice to apply the recognition and measurement requirements of IFRS 9 or IAS 39. Therefore, the FRC has considered how the IASB's proposals might be reflected in FRS 102 in order that the proposed relief is available to all entities, regardless of their accounting policy choice in relation to financial instruments.

6 This FRED has been drafted on the basis of ED/2019/1, which was open for comment until 17 June 2019. The IASB is expected to finalise the amendments by the end of 2019, which are applicable for accounting periods beginning on or after 1 January 2020. In order to make similar relief available to entities applying FRS 102 within a consistent timeframe, the FRC decided to consult on the basis of the IASB's proposals, rather than waiting for the final amendments. As a result, when considering respondents' feedback to this FRED, the FRC will also consider how the IASB finalised its proposals and may make further changes to the proposals to reflect the final amendments issued by the IASB.

Effective date

7 The proposed effective date is accounting periods beginning on or after 1 January 2020. Although the IASB is expected to finalise its amendments by the end of 2019 it may not be possible to finalise the amendments to FRS 102 until early 2020, but this will not change the effective date.

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 These proposals will only affect entities that choose to apply hedge accounting.

3 The IASB has proposed amendments to IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* to provide relief during the period of uncertainty before the interest rate benchmark is replaced, and avoid the early discontinuation of hedge accounting in certain situations. The recognition and measurement requirements of IFRS 9 are available as an accounting policy choice to entities applying FRS 102, and the underlying need for the amendments could apply equally to entities applying FRS 102, therefore the FRC decided to make equivalent relief available to all entities applying FRS 102.

4 The proposals avoid the discontinuation of hedge accounting solely due to uncertainties about interest rate benchmark reform before its economic effects are known. This will be of benefit to users of financial statements, as the early discontinuation of hedge accounting would not provide useful information to users.

Conclusion

5 Overall, the FRC believes that the draft amendments to FRS 102 will have a positive impact on financial reporting.

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 20 September 2019.

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.

FRC

Further copies, £14.00 (post-free) can be obtained from
FRC Publications
Lexis House
30 Farringdon Street
London
EC4A 4HH

Tel: **0845 370 1234**
Email: **customer.services@lexisnexis.co.uk**
Or order online at: **www.frcpublications.com**

ISBN 978-0-7545-5644-2

9 780754 556442