Financial Reporting Council

March 2016

# 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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# *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

## Fair value hierarchy disclosures

*Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Fair value hierarchy disclosures* is an amendment to an accounting standard. It is issued by the Financial Reporting Council in respect of its application in the United Kingdom and promulgated by the Institute of Chartered Accountants in Ireland in respect of its application in the Republic of Ireland.

# 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.

These limited amendments to FRS 102 simplify the preparation of disclosures about financial instruments for financial institutions and retirement benefit plans.

(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.

### Amendments to FRS 102 – Fair value hierarchy disclosures

(iv) These amendments to FRS 102, which are relevant only to financial institutions and retirement benefit plans, were consulted on in FRED 62 *Draft amendments to FRS 102 – Fair value hierarchy disclosures*. They relate to the disclosure of financial instruments in an analysis based on the fair value hierarchy. Taking into account the feedback to FRED 62 these amendments 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.

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

## Amendments to Section 1
## *Scope*

1 The following paragraph sets out the 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 to an accounting period beginning before 1 January 2017 it shall disclose that fact.</u>

## Amendments to Section 34
## *Specialised Activities*

3 The following paragraphs set out the 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 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.

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.

## Approval by the FRC

*Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Fair value hierarchy disclosures* was approved for issue by the Board of the Financial Reporting Council on 3 March 2016, following its consideration of the Accounting Council's Advice.

# The Accounting Council's Advice to the FRC to issue *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 *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 *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 amendments 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 The Accounting Council's Advice to the FRC to issue FRS 102 was set out in the standard. The Accounting Council's Advice to the FRC in respect of these amendments will be included in the revised FRS 102.

## Background

8 The FRC had received feedback that amending the fair value disclosure requirements applicable to financial institutions and retirement benefit plans would 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.

9 The FRC consulted on proposals to address this in FRED 62 *Draft amendments to FRS 102 – Fair value hierarchy disclosures*. The responses to FRED 62 confirmed the earlier feedback.

## Amendments to FRS 102

10 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.

11 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.

12 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.

13 Following the postponement of the triennial review of FRS 102 by one year, the FRC consulted on proposals to amend the disclosure requirements for financial institutions and retirement benefit plans in FRED 62 issued in November 2015. The amendments do not affect any other entities applying FRS 102, and do not otherwise disrupt the three-year stable platform for small entities.

14 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 amendment affected only a small number of entities (and that stability would be retained for the remainder) and related to streamlining disclosures it was appropriate to advise a change in FRS 102 outside the triennial review. This was supported by the respondents to FRED 62, a number of whom encouraged the amendments to be finalised as soon as possible.

15 The Accounting Council noted that paragraphs 34.22 and 34.42 of FRS 102 required 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 would 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 noted 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.

16 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*

17 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 amendments do not impact on any other entities applying FRS 102.

18 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. Respondents to FRED 62 agreed with this conclusion.

## Effective date

19 The Accounting Council advises that these amendments to FRS 102 should be effective for accounting periods beginning on or after 1 January 2017, with early adoption permitted.

20 However, as the amendments relate to disclosure only, and early application is permitted, an entity may be able to apply the amendments to financial statements for periods ending on 31 December 2015 if those financial statements are approved after these amendments are issued.

21 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 will, however, require amendment in due course.

## Approval of this Advice

22 This advice to the FRC was approved by the Accounting Council on 25 February 2016.

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