Financial Reporting Council

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Exposure Draft *Risk Mitigation Accounting—Proposed amendments to IFRS 9 and IFRS 7*

Dear Sam,

The Financial Reporting Council (FRC) welcomes the opportunity to provide comments on the above Exposure Draft[1].

This response draws on the FRC's experience in developing financial reporting standards applicable in the UK and Republic of Ireland. The FRC's overriding objective in developing financial reporting 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. In achieving its overriding objective, the FRC aims to provide succinct financial reporting standards that, amongst other things, have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective.

We note that there is no specific question in the Exposure Draft in respect of the proposed amendment to add disclosure requirements to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*. Given the IASB's intended approach to maintaining IFRS 19, we suggest the inclusion of such a question whenever an exposure draft proposes changes to that standard. This will provide a clear opportunity for stakeholders to comment on the proposals, and for the IASB to reflect on the IFRS 19 implications as part of the finalisation of the underlying requirements.

Relevance of the proposals to local GAAP in the UK and Ireland and key feedback

The IASB's proposals for Risk Mitigation Accounting are likely to affect some entities in the UK and Ireland that do not directly apply IFRS Accounting Standards. This is as a result of options we have made available in local GAAP. In Appendix B to this letter we summarise how the

[1] *Exposure Draft: Risk Mitigation Accounting—Proposed amendments to IFRS 9 and IFRS 7*

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proposals in the Exposure Draft will interact with the applicable financial reporting standards in the UK and Ireland.

Our perspective in responding is to comment only on the proposals in relation to IFRS 19, taking into account our experience in setting a reduced disclosure standard[2] applicable to subsidiaries and the costs and benefits associated with the financial statements of subsidiaries.

In particular we think that the costs of applying the proposals could be reduced by omitting from IFRS 19 the requirement to apply paragraph 33A of IFRS 7 when risk mitigation could have been applied but has not been.

Responses to the questions for respondents

Our detailed comments are included in Appendix A. If you have any queries or would like to discuss our comments in more detail, please do not hesitate to contact Stephen Maloney (Senior Project Director) or Merrik Bousfield (Project Director) at ukfrs@frc.org.uk.

Yours sincerely



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[2] FRS 101 *Reduced Disclosure Framework*

Appendix A: Responses to the questions for respondents

A1 The FRC is not responding to questions 1-9 or question 11 in Exposure Draft *Risk Mitigation Accounting—Proposed amendments to IFRS 9 and IFRS 7* ('the Exposure Draft').

A2 Question 10 relates to the proposed new presentation and disclosure requirements to be included in IFRS 7 *Financial Instruments: Disclosures*:

Question 10—Disclosure requirements (proposed amendments to IFRS 7)

The IASB is proposing new presentation and disclosure requirements to be included in IFRS 7 *Financial Instruments: Disclosures*.

Paragraph 30E would require an entity to present separately from other line items:

a) the risk mitigation adjustment, either as part of the entity's assets (when it has a debit balance) or as part of its liabilities (when it has a credit balance) in the statement of financial position; and

b) the amount of the risk mitigation adjustment recognised in profit or loss during the period in the statement of comprehensive income.

Paragraphs 30F–30P would require an entity that applies risk mitigation accounting to disclose information that enables users of financial statements to understand:

a) how the entity manages repricing risk according to its risk management strategy;

b) how the entity's risk management activities could affect the amount, timing and uncertainty of its future cash flows; and

c) how risk mitigation accounting has affected the entity's statement of financial position and its statement of comprehensive income.

Paragraph 33A would apply to entities whose business and risk management activities have the characteristics specified in the proposed paragraph 7.1.4 of IFRS 9 but that choose not to apply risk mitigation accounting. Such entities would be required to provide a qualitative explanation of how they manage repricing risk.

Paragraphs BC148–BC171 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

A3 The FRC does not comment on the proposed amendments to IFRS 7. However, as set out in our cover letter, the FRC offers a comment on the proposed amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*.

A4 The invitation to comment contains no specific question about the proposed amendments to IFRS 19. Given the IASB's approach to maintaining IFRS 19, the FRC suggests the inclusion of such a question whenever an exposure draft proposes changes to that standard.

A5 The Exposure Draft proposes the insertion of subparagraph 4(ba) in IFRS 19, which would require:

a) an entity applying risk mitigation accounting to apply all related disclosure requirements in paragraphs 30D-30P of IFRS 7; and

b) an entity that carries out risk management activities applicable to risk mitigation accounting but that chooses not to apply risk mitigation accounting to apply all related disclosure requirements in paragraph 33A of IFRS 7.

A6 In other words, the Exposure Draft proposes no disclosure reduction for entities applying IFRS 19. Paragraphs BC177 and BC178 of the Basis for Conclusions to the Exposure Draft explain the IASB's reasoning.

Inclusion of presentation requirements in IFRS 19

A7 Proposed paragraph 30D of IFRS 7 introduces 'the presentation and disclosure requirements in paragraphs 30E-30P'. Paragraph 30E sets out presentation requirements.

A8 The FRC considers that there is, therefore, potential ambiguity in an entity applying IFRS 19 being required by proposed subparagraph 4(ba) to apply 'all related disclosure requirements in paragraphs 30D-30P'. It may not be clear whether this is intended to include the presentation requirements in paragraph 30E.

A9 Depending on the IASB's intention, alternative drafting for subparagraph 4(ba) of IFRS 19 could be:

a) 'apply all related <u>presentation and</u> disclosure requirements in paragraphs 30D-30P of IFRS 7'; or

b) 'apply all related disclosure requirements in paragraphs ~~30D~~<u>30F</u>-30P of IFRS 7'.

Inclusion of disclosure objective in IFRS 19

A10 Proposed paragraph 30F of IFRS 7 sets out a disclosure objective for the disclosures to be made in accordance with paragraphs 30G-30P.

A11 Paragraph BC50 of the Basis for Conclusions to IFRS 19 explains that the IASB concluded that including disclosure objectives in IFRS 19 'might result in the perception that entities are required to provide the same disclosures they would otherwise have provided had they not applied IFRS 19'. The IASB therefore decided to exclude disclosure objectives from IFRS 19.

A12 The IASB's proposal to include in IFRS 19 the disclosure objective in proposed paragraph 30F of IFRS 7 is therefore a departure from its previous conclusion. We understand that this is consistent with the IASB's proposal that all the proposed new disclosure requirements should, indeed, be applicable to an entity applying IFRS 19. However, we suggest that the IASB sets out more clearly that this is a deliberate and isolated departure from its previous conclusion, rather than setting a precedent. This could be done in the Basis for Conclusions, and subparagraph 4(ba) could also explicitly state the requirement in this case to apply the disclosure objective.

Disclosure requirements for an entity applying IFRS 19

Disclosure requirements for an entity applying risk mitigation accounting

A13 As noted above, the Exposure Draft proposes that an entity applying IFRS 19 which applies risk mitigation accounting will be required to provide all the disclosure requirements set out in paragraphs 30G-30P of IFRS 7.

A14 Without prejudice to any future deliberations about whether to offer disclosure exemptions in our financial reporting standard FRS 101 *Reduced Disclosure Framework* for any disclosures introduced into IFRS 7, the FRC agrees with the IASB's reasoning (set out in paragraphs BC177 and BC178 of the Basis for Conclusions to the Exposure Draft) for wishing to offer no disclosure reduction in IFRS 19.

A15 We agree that any given entity applying IFRS 19 can be expected to know whether or not it has applied risk mitigation accounting, and therefore whether or not the requirement to apply paragraphs 30D-30P of IFRS 7 applies. In contrast, we do not agree that any given entity applying IFRS 19 can necessarily be expected to know whether or not it *could have* applied risk mitigation accounting.

Disclosure requirements for an entity not applying risk mitigation accounting

A16 As noted above, the Exposure Draft proposes that an entity applying IFRS 19 that carries out risk management activities applicable to risk mitigation accounting but that chooses not to apply risk mitigation accounting will be required to 'apply all related disclosure requirements in paragraph 33A of IFRS 7'.

A17 We note that, for an entity not applying IFRS 19, proposed paragraph B7.1.10 of IFRS 7 refers to a requirement to 'provide the disclosures required by paragraph 33A of IFRS 7'. As a simpler articulation, this may be easier to understand than the proposed requirement for an IFRS 19 preparer to 'apply all related disclosure requirements in paragraph 33A'.

A18 Proposed paragraph 33A of IFRS 7 requires that, when an entity's business and risk management activities have the characteristics that would make risk mitigation accounting available but the entity has chosen not to apply risk mitigation accounting, the entity provides a qualitative explanation to enable users of its financial statements to understand how the entity manages its exposure to repricing risk.

A19 The FRC considers that it may be disproportionate to require an entity applying IFRS 19 to comply with proposed paragraph 33A of IFRS 7. Without comment on whether the disclosures required by that proposed paragraph are appropriate in general, we are concerned about the time and resources that may need to be spent by an entity applying IFRS 19 to determine whether they apply.

A20 Whereas an entity applying IFRS 19 can be expected to know whether or not it has applied risk mitigation accounting, we do not think it will be obvious to all IFRS 19 preparers whether they *could have applied* risk mitigation accounting. We think it possible for an entity to carry out activities that would enable it to apply risk mitigation accounting, without necessarily being aware that risk mitigation accounting would have been an option, or making an explicit decision not to apply it. We expect that the same is true of existing hedge accounting provisions.

A21 Additional burdens may arise within a group which applies risk mitigation accounting, if each individual subsidiary needs to determine not only whether it applies risk mitigation accounting but, if not, whether it *could have* done so.

A22 Accordingly, we are concerned that the proposed drafting will lead to entities which apply IFRS 19 and which do not apply risk mitigation accounting needing to spend time and resources determining and documenting whether they 'carry out risk mitigation activities applicable to risk mitigation accounting' on an entity-by-entity basis.

A23 As noted in paragraph BC177 of the Basis for Conclusions to the Exposure Draft, the IASB concluded that 'most of the entities that carry out applicable risk management activities and qualify to apply risk mitigation accounting would not be eligible to apply the requirements in IFRS 19'. This being the case, the FRC suggests that it would be appropriate to omit from IFRS 19 the requirement to apply paragraph 33A of IFRS 7 when risk mitigation could have been applied but has not been.

A24 Any risk of users missing out on qualitative information about how an entity manages its exposure to repricing risk would be mitigated, at least in part, by the fact that an entity

applying IFRS 19 must by definition be included in consolidated financial statements available for public use that comply with IFRS Accounting Standards.

Suggested alternative drafting

A25 As a result of our suggestions above, the FRC suggests that (presuming that the IASB intends to include the disclosure objective) an alternative drafting for proposed subparagraph 4(ba) of IFRS 19 could be as follows (with mark-up showing the difference from the proposal in the Exposure Draft):

(ba) if an entity applying this Standard applies risk mitigation accounting in accordance with Chapter 7 of IFRS 9 *Financial Instruments*, it shall apply ~~all related disclosure requirements in paragraphs 30D-30P~~ the presentation requirements in paragraph 30E, the disclosure objective in paragraph 30F, and the disclosure requirements in paragraphs 30G-30P, of IFRS 7 *Financial Instruments: Disclosures*. ~~If an entity applying this Standard carries out risk management activities applicable to risk mitigation accounting (see paragraph 7.1.4 of IFRS 9) but chooses not to apply risk mitigation accounting, it shall apply all related disclosure requirements in paragraph 33A of IFRS 7.~~

Appendix B: Financial reporting standards in the UK and Ireland

FRS 101 *Reduced Disclosure Framework*

B1 The FRC's financial reporting standards include FRS 101 *Reduced Disclosure Framework*, which has a similar purpose to IFRS 19, although with a different scope and constructed in a different manner. FRS 101 became effective in 2015, and has proved popular with eligible preparers.

B2 We maintain FRS 101 by conducting an annual review considering new and amended disclosure requirements issued by the IASB that year. As a result, the implications for FRS 101 of the *Risk Mitigation Accounting* project will be considered in a future year after final amendments have been issued by the IASB. Our comments are therefore provided without prejudice to any future deliberations and decisions in relation to FRS 101.

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

B3 The FRC's financial reporting standards also include FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. FRS 102 is the main 'UK GAAP' standard, applied by entities of a wide range of sizes and legal forms, including some financial institutions. The requirements in FRS 102 were based on the *IFRS for SMEs* Accounting Standard, modified in terms of the scope of entities eligible to apply it, the accounting treatments provided, and the required disclosures. In some instances, those modifications include incorporating requirements that are consistent with IFRS Accounting Standards.

B4 A small proportion of preparers applying FRS 102 may be impacted by the *Risk Mitigation Accounting* proposals, because the standard offers an accounting policy choice to apply the recognition and measurement requirements of IFRS 9 *Financial Instruments*. The FRC expects the effects of the proposals on such entities to be comparable to the effects on smaller entities which apply IFRS Accounting Standards. We note that the UK Endorsement Board has been considering the perspective of smaller entities during the preparation of its own response to the Exposure Draft. The FRC has therefore encouraged affected FRS 102 preparers to engage with this project, either directly with the IASB or via the UK Endorsement Board.