Financial Reporting Council

December 2020

Impact Assessment and Feedback Statement

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

Interest rate benchmark reform (Phase 2)

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Contents

Overview

(i) International interest rate benchmarks, including the London Interbank Offered Rate (LIBOR), are being reformed and these reforms have wide-ranging implications for entities that make reference to these interest rate benchmarks as part of contractual terms, most commonly related to the payment or receipt of interest. The publication of LIBOR is expected to cease after 2021 and entities that reference LIBOR in their contracts, have to contractually agree alternative benchmark rates before that date. The reforms of interest rate benchmarks are expected to affect many entities, because the use of interest rate benchmarks in contracts is wide-spread.

(ii) In December 2020 the FRC issued *Amendments to FRS 102 – Interest rate benchmark reform (Phase 2)*, to address the financial reporting implications of the replacement of interest rate benchmarks as part of the interest rate benchmark reforms. This Impact Assessment and Feedback Statement accompanies those amendments, which represent the second and last phase of the FRC's standard-setting response to financial reporting issues arising from the international reforms of interest rate benchmarks.

(iii) The FRC also assessed whether amendments to FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime* were needed for the effects of the interest rate benchmark reform. We concluded that it is not necessary. FRS 105 does not contain the same specific requirements as FRS 102 to which the reliefs relate. We believe the same accounting outcome as under FRS 102 can be achieved under FRS 105 without the need for explicit reliefs.

(iv) The Impact Assessment and Feedback Statement:

  (a) sets out the Impact Assessment for these amendments, after taking account of respondents' comments on the Consultation stage impact assessment; and

  (b) summarises the nine responses received to FRED 74 *Draft amendments to FRS 102 – Interest rate benchmark reform* (Phase 2) and the FRC's response to them.

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.

Amendments to FRS 102

2 The possible accounting effects of interest rate benchmark reforms could not be anticipated when FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was developed. Although FRS 102 is a principle-based standard and thereby provides some flexibility for entities to determine the appropriate accounting for certain transactions and events, some of the standard's requirements may not have resulted in useful information and could have posed an excessive reporting burden in the context of interest rate benchmark reform.

3 Interest rate benchmark reform is an international effort addressing global systemic issues. The FRC therefore decided that its financial reporting solutions addressing interest rate benchmark reforms should be based on solutions issued by the International Accounting Standards Board (IASB), with appropriate changes to reflect differences between International Financial Reporting Standards (IFRS) and FRS 102. The IASB developed its amendments in two phases and the FRC adopted the same approach. The basis for developing the FRS 102 solutions was supported by respondents.

4 In December 2019, the FRC issued a first set of amendments, referred to as Phase 1, in *Amendments to FRS 102 – Interest rate benchmark reform*. Phase 1 focused on the effects of the uncertainties over the long-term viability of some interest rate benchmarks and provided reliefs for hedge accounting.

5 The second set of amendments issued in December 2020, referred to as Phase 2, addressed the financial reporting implications arising from the actual replacement of interest rate benchmarks, which are wider than those of the first phase. We therefore expect that these amendments will affect and provide relief for a potentially large number of entities.

6 Amendments to Section 11 *Basic Financial Instruments* provide a practical expedient, which enables entities to account for changes to contractual cash flows as a direct consequence of interest rate benchmark reform, as if they were a re-estimation of the cash flows of a variable rate financial instrument. The practical expedient simplifies the accounting and entities do not need to assess the changes in the context of other existing FRS 102 requirements. It also ensures consistency of reporting of the effects of interest rate benchmark reform. Other changes to financial assets or financial liabilities continue to be assessed in accordance with the existing requirements in FRS 102. Amendments to Section 12 *Other Financial Instruments Issues* for hedge accounting enable entities to redocument their hedges and provide other reliefs that avoid discontinuation of hedge accounting.

7 Since these amendments are designed to ease the reporting requirements for entities, we believe entities will benefit from reduced costs compared to a situation without the amendments. Nevertheless, we expect entities to incur some additional costs associated with the amendments, although they will be small. The additional costs relate primarily to the requirement for the redocumentation of hedges, some additional disclosures and, if applicable the need to separate changes in contractual flows between those that are

required by interest rate benchmark reform and those changes that arise for other reasons.

8 In summary we believe the key benefits of the amendments are:

(a) minimising the financial reporting costs of changes to financial instruments as a result of interest rate benchmark reform;

(b) avoiding the discontinuation of hedge accounting solely due to changes to hedge documentation arising from changes in benchmark rates;

(c) providing useful information to users (because otherwise the derecognition and re-recognition of financial assets and liabilities or the early discontinuation of hedge accounting would not provide useful information to users);

(d) ensuring consistency of reporting of the effects of interest rate benchmark reform; and

(e) maintaining consistency with international accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*[1].

Conclusion

9 Overall, the FRC believes that the amendments to FRS 102 will have a positive effect on the quality of financial reporting and reduce the burden of financial reporting.

[1] The financial instruments accounting requirements in FRS 102 are based on IAS 39 and on IFRS 9. FRS 102 provides an accounting policy choice between the requirements of Section 11 and Section 12 of FRS 102 and the recognition and measurement requirements of IFRS 9 or IAS 39. The IASB amended IFRS 9 and IAS 39 to address the implications of interest rate benchmark reforms.

Feedback Statement

10 The purpose of this Feedback Statement is to summarise the comments received in response to FRED 74 *Draft amendments to FRS 102 – Interest rate benchmark reform (Phase 2)*. FRED 74 was issued in May 2020 and the comment period closed on 30 September 2020.

11 The table below shows the number of respondents and analyses them by category.

Table 1: Respondents by category

	No. of respondents
Accountancy firms	5
Accounting professional bodies	3
Other	1
	9

12 FRED 74 posed two questions, and the feedback and FRC response to them are summarised below.

Question 1

> Do you agree with the proposed amendments to FRS 102? If not, why not?

Table 2: Respondents' views on Question 1

	No. of respondents
Agreed	1
Agreed, with recommendations for improvement	8
Disagreed	–
	9

13 The proposals in FRED 74 were based on similar proposals made by the IASB. The respondents broadly agreed with the proposals in FRED 74, but most respondents made recommendations for improvements.

14 Respondents encouraged the FRC to align the amendments in FRS 102 with those made by the IASB in August 2020[2] and a few made specific suggestions to achieve greater consistency. There were also some suggestions for departures from the IASB's amendments, including the extension of the deadline for the redocumentation of hedges and the extension of the relief for risk components beyond 24 months.

15 A couple of respondents commented on the accounting for modifications of financial instruments that do not result in derecognition, although this was not the subject of this consultation. One respondent urged the FRC to avoid inadvertently making changes to FRS 102 when making these amendments, whilst the other respondent was seeking greater clarity and advised including more specific requirements consistent with those in IFRS 9.

[2] *Interest Rate Benchmark Reform – Phase 2 Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16*

16 One respondent to the consultation suggested that in addition to the proposed reliefs for finance leases of lessees, the FRC should also contemplate providing relief to lessors, whilst another respondent suggested clarification of the effect of interest rate benchmark reform on all types of leases.

FRC response

17 The FRC's approach for the second phase of amendments is the same as for the first phase, ie developing an IFRS-based solution with suitable adaptations, including simplifications, for entities applying FRS 102.

18 We have made a number of amendments to the proposals in FRED 74 to align with the amendments by the IASB and made other amendments suggested by respondents when they struck an appropriate balance between ease of reporting and usefulness of the information in the context of FRS 102.

19 We have not made changes to the existing requirements in FRS 102 regarding the accounting for modifications of financial instruments, except for the practical expedient provided specifically related to interest rate benchmark reform. However, considering the views expressed by respondents on this topic the FRC will revisit this as part of a future periodic review of FRS 102.

20 We have reconsidered the proposals in respect of lease accounting and decided that it is not necessary to provide specific lease accounting reliefs in FRS 102 for lessees or lessors. Some additional comments have been included in the Basis for Conclusions of FRS 102 as requested by a respondent.

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.

Table 3: Respondents' views on Question 2

	No. of respondents
Agreed	6
Disagreed	–
Did not comment[3]	3
	9

21 All of the respondents commenting agreed with the assessment in FRED 74 that the proposals will have a positive impact on financial reporting because the proposals will

(a) minimise the financial reporting costs;

(b) avoid the discontinuation of hedge accounting solely due to changes to hedge documentation arising from changes in benchmark rates; and

(c) benefit users of financial statements, as the derecognition and re-recognition of financial assets and liabilities or the early discontinuation of hedge accounting would not provide useful information to users.

[3] Includes those respondents that stated that they had no comments in relation to Question 2 and those that did not address Question 2.

22 One respondent noted that in addition to these benefits the proposals assist in ensuring consistency of accounting applied by entities.

FRC response

23 The costs and benefits of these amendments have been included in the Impact Assessment. Overall, the amendments to FRS 102 will have a positive effect on the quality of financial reporting and reduce the burden of financial reporting.

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