

The Fair Value Hierarchy under FRS 102 – *Impact on investment funds*

Background to FRS 102

As of 1 January 2015 UK and Irish GAAP has been replaced by FRS 102, a new accounting standard largely based on IFRS for SME's. Thus it is inevitable that there will be amendments required to the financial statements of funds previously prepared under UK and Irish GAAP.

The purpose of this paper is to assist preparers of financial statements in ascertaining which classification relevant investments will fall within the fair value hierarchy under FRS 102.

FRS 102 fair value hierarchy – the problem

FRS 102 duplicates the three-level fair value measurement hierarchy in IFRS for SMEs. However; this hierarchy is an anomaly arising from the significant simplifications made to the measurement requirements of IAS 39 by the IASB in finalising IFRS for SMEs and is not a replica of the fair value hierarchy criteria set out in IFRS 13.

The table below shows the correlation between the levels applied in the application of IFRS 13 and FRS 102.

IFRS 13	Valuation methodology	FRS 102
Level 1	Quoted prices for identical instruments in active market	Classification A
Level 2	Prices of recent transactions for identical instruments	Classification B
	Valuation techniques using observable market data	Classification C
Level 3	Valuation techniques using unobservable market data	

Illustrative examples

The aside table sets out some illustrative examples of classifications under IFRS and FRS 102.

Product Type	Under IFRS	Under FRS 102
Asset-Backed Securities	3	C
Corporate Bonds	2	C
Exchange Traded Derivatives (futures, options)	1	A
Funds (exchange traded)	1	A
Funds (valued daily or weekly)	2	B
Funds (valued fortnightly, monthly, quarterly)	2	C
Government Bonds	2	C
OTC Derivatives (swaps, forwards, options)	2	C
Private Equity	3	C
Quoted Equity Securities	1	A
US Treasury Bills (short dated maturity)	1	A

As can be seen from the above, funds that prepare their financial statements in accordance with FRS 102 will be required to report more of their financial instruments in the lowest of the three classifications. Consequently, there is a risk of users misinterpreting the lowest level of the FRS 102 hierarchy as being comparable to the IFRS hierarchy; unintentionally impacting on external views of the quality of certain assets held by the fund. Additional disclosures may therefore be required in financial statements prepared under FRS 102 so as to avoid investor confusion and increase comparability to other accounting standards.

Contact us

If you have any further questions please contact a member of our team.



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