Objective of risk mitigation accounting [DCL A1-A6]

UKEB says: "The UKEB's DCL notes that the UKEB is not yet in a position to provide a clear view as to whether the Proposed Amendments will achieve their objectives. Stakeholder feedback, including the results of fieldwork, will be key in assessing whether this is the case".

1. Do you consider that the Proposed Amendments will result in an accounting outcome that would reflect the economics of organisations' risk management practices?

If your answer is no, could you please explain why and what would you recommend instead?

Yes ☐ No ☐ X

Explanation: There are a number of points. The questions need to be considered step by step.

1. The essence of a properly prepared set of financial statements is that they comply with laws and standards (which themselves need to be stable). They must record existence (of event or change); match (upside, downside, movement, change, recording capital and retained earnings transfers, appropriations, dissemination); apply principles consistently within the period of account (usually a year) and over periods of account; state policies and use narrative to inform and explain; have prudent approach. The standard setter must not indulge in micro specification, because they then lose independence and the preparer cannot say "these are ***our*** accounts". One can anticipate that where trained and experienced people are the preparers, then as between one company and another, in similar circumstances, or comparable, the outcome will correspond, ie look the same. Personal judgment does not, or should not, feature.

1.1. The question raises alarm bells. First the question of economics. This does not feature in financial statements in any form. Economics is not a set of accounting standards. Economics is to do with theories of behaviour and, at a macro level, addresses questions like what to do about market failures, and anti-trust issues (cartels, monopolies, etc). It recognises public goods. The expeditious publishing by UKEB of evidence it receives, is a prime example of creating public goods. It is to be commended. Everyone has access including the public and standard setters working internationally, including those registered in Delaware with no accountability who may or may not pay any attention. Therefore "economics" should be purged as a component of accounting. Please note, a term was coined of "economic crime" some two decades ago. This is defined as "victimless" crime, meaning so many members of the public affected that prosecutors did not owe duty to anyone. Police have duty to "the public" but none to an individual victim unless assumed.

1.2. An "organisation's risk management practices" is confidential to its board. An enterprise which is quoted must have a risk register which must be maintained and an auditable trail of risk mitigation or elimination and monitoring and evaluating. SMES tend to do this exercise daily and it is bread and butter to them by force of habit and commitment. The books and records which must be kept under the Acts, must be sufficient to ascertain the financial trading position of an enterprise at all times, which is post risk evaluation and recording steps taken with audit trail.

1.3. We have evidenced to UKEB previously: *"The UK is governed by the Companies Acts in this area (other statutes also apply). The Companies Acts make the rules on the obligation to maintain the books of prime record, sufficient to be able to ascertain the financial trading position of the enterprise at all times. These must be the basis for the creation of the nominal ledger and the extraction of estimates to create draft accounts, management reports, prepare for auditor's reports, inclusive of those comprising letters to management, addressed to those charged with the governance of the enterprise. Office holders must have this demonstrable experience and public track-record, including cross border"……."The articles of the company set out directors' obligations severally and as a board. Compliance with standards is in the Acts"…."The Company Secretary and record keeper is possibly more important than anyone else* [for records and trail].

1.4. To this we add that fundamental financial uncertainty is notifiable and it is an offence to put a false panic in the market. The buck stops with the directors severally and that is why they are indemnified under the articles, as they must safeguard the assets of the enterprise and carry uncapped duty.

1.5. We recommend that creation and maintenance of accounting policies should replace "*risk management practices*" as the rest is already covered in the discharge of duty. Practices are what people habitually do and are not documented and followed and audited like accounting policies. The internal controls risk register is an audited record and, if not live and maintained, an enterprise will fail its internal controls audit and be landed with 100% testing in each area of breakdown. As SMEs we require our supply chains to have good quality controls and robust independent auditors (who know what they are doing).

1.6. We also recommend addressing the issue we gave evidence on to UKEB previously. *"Accounting standards have gone awry over the last two decades and are no longer capable of being read through from start to finish and understood by an educated company director (or articled clerk / trainee / apprentice). The proliferation of acronyms continues to worsen and the use of hyper links to long complex important records, especially those identifying policy, which are enlightening, give the strong impression that the preparer of the document in which the hyper link appears, knows about it but they have neither read and understood it properly nor evaluated its impact on the document they created".*

1.7. *"Importantly, it is impossible to find the first emanating standard* [on any particular topic] *to get to grips with the application of principles. The standard should be accompanied by guidelines, specific examples and practice notes which are non-binding. In many instances, the effect of adding complexity on complexity is that the original intention is obscured. There is no publicly accessible library with informed librarian provided by FRC in every local authority. This is the UK Competent Authority and Standard Setter. Therefore the public has nowhere to go to inform itself sufficiently to respond to an Equalities Act Consultation. FRC is not forthcoming under FoI unless taken to court. There are complaints in Parliament (anecdotal evidence) that MPs pass changes and law not fully appraised of the impact on the public, until faced with their constituents who are in a pickle and knots, and there is no operational route to get a correction done. The (potential) office holder must have had practical experience of these closed doors and be inspired in breaking them down publicly, so the public can know what it is doing when drawing up a set of accounts. Without this, the whole system of standards is impenetrable spaghetti, and does not inspire confidence*."

1.8. We recommend there is a wholesale review of standards, with reference to the first in each topic to identify basic mandatories. We wrote previously: "*No longer are directors able to understand and apply accounting standards based on their analysis of the transactions and risks. The creator of the standards becomes the preparer essentially, with the result being in the name of the office holders. Anyone looking for a report and accounts which hang together and officers can explain to members, will not be able to find them."* We also add now that auditors must make public access to individuals for the public to give evidence to the auditor relevant to the auditor's discharge of duty. Blocking email to block evidence should automatically excluded a firm from being ICAEW /ICAS registered to run training contracts at least.

Objective of risk mitigation accounting [DCL A1-A6]

2. Do you consider that the Proposed Amendments could be implemented in practice without undue cost or effort?

If your answer is no, what areas are likely to cause significant cost or effort?

Yes ☐ No ☐ X

Explanation:

2. Neither "cost" nor "effort" are considerations.

2.1. Where there is a problem or a series of problems, or series of amendments to an incorrect emanating premise, unfortunately unless one goes back to the beginning and starts again, the situation will worsen, not improve. At the very best, the public has to do what the courts call "disinter" to work out how one got to the deadlock of the present. UKEB describes the problem as:

Background
The implementation of IFRS 9 Financial Instruments aimed to introduce improved hedge accounting requirements. However, this did not provide a solution for complex risk management situations where risks are managed dynamically. In such cases entities were permitted to continue applying IAS 39 Financial Instruments: Recognition and Measurement. The IASB have noted that entities continue to find it challenging to account for their dynamic risk management activities in this manner, as the requirements are not designed for such situations, and the constraints make it difficult for entities to faithfully represent the economic effect of such risk management activities.

The scope of the Exposure Draft is limited to interest rate repricing risk, in instances where entities meet the criteria to demonstrate that this risk is being managed dynamically. The Exposure Draft aims to provide a more faithful representation of the entity's understanding of its economic position for such risk management activities.

Consistent with the existing hedge accounting requirements of IFRS 9, the proposed requirements are voluntary. It is proposed that IAS 39 be withdrawn once the proposed amendments are available for use.

Alongside the Exposure Draft, the IASB published a snapshot of the proposed amendments as well as a request for fieldwork with preliminary and final results required by 31 July 2026 and 30 November 2026 respectively.

2.2. The identified problem is IFRS 9 "financial instruments". Therefore the only solution is to go back to the first standard in the series and start again. Dynamic risk management is what SMEs have to do all day every day. How can a standard be created which excludes consideration of SMEs and incorporating their experience of what is expected, not only of them, but suppliers and suppliers to suppliers (eg auditors).

2.3. We have already evidenced to UKEB on requirements for dynamic risk management and volatility in conditions markets and supply chains including foo an fuel. We wrote: *"International and global trade happens regardless of accounting standards adopted. International consolidations also straddle jurisdiction. Geopolitics plays a very large part. Pricing and risk are driven by war, famine, supply chains. The picture changes almost daily. The UKEB approach reflects political alignment which is transient and does not take into account international power broking. Capital markets themselves are volatile. Pegging rock solid standards that directors must understand and apply to volatility in international markets, turns financial statements (set to be a set of software coded or translated data sets) into a gambling casino and knowingly bringing volatility out of the officers control into accounts."*

Objective of risk mitigation accounting [DCL A1-A6]

3: Do you consider that the Proposed Amendments would result in information that is more useful compared to the information that is currently available in IFRS financial statements ? Please explain.

Yes ☐ No ☐ X

3. Explanation: Please see replies to (1) an (2). A patch on a patch on a patch does not fix the problem or improve understanding. This is required before making the entries in the books of prime record. Most organisations especially in financial services do not know how any staff and contractors they engage an in the case of insurers no idea of the risks they are underwriting, as the broker keeps the book an tells them nothing. Re-insurers carry that black-hole but do not care because the auditor does not either and looks the other way to ensure he never finds out. It is the complacency that is hardest to understand.

Credit risk [DCL A7-A9]

4: The Proposed Amendments are silent in relation to the consideration of the effects of credit risk in the net re-pricing risk exposure. The UKEB's DCL suggests explicitly stating that an organisation should consider the effects of credit risk in accordance with its risk management strategy. It also notes that if that was not the IASB's intended interpretation, further clarification and guidance would be needed.

Do you agree with this position? Please explain why or why not.

Yes X ☐ No ☐

Explanation:

4. UKEB's DCL states (above) that "*an organisation should consider the effects of credit risk in accordance with its risk management strategy*". However this is the responsibility of the officers of the enterprise. They have to identify all risks and document what they are doing about them and incorporating a suitable internal controls framework that is subject to internal an eternal audit. The governance of an enterprise is not per se an issue for accounting standards setting. It is for the auditor who must evaluate the efficacy of the outcome and write a letter to management in the case of shortcomings and consider resigning where there has been no repair, the issue is significant and self reporting to the successor of DTI is required. The risks register reflects what the enterprise is doing and the auditor verifies that it works.

4.1. It is correct hat any risk post mitigation must be considered in the context of the totality of risk, which is against a backdrop of uncertainty. We have previously evidenced to UKB: "*Global instability, climate devastation, famine, war, geopolitics and national security to say nothing of the uncontrollable activities of the key tech power brokers in AI, means that there has to be constant appraisal, flexibility*, ……"

4.2. We do not agree with micro managing in accounting terms one area, because a preparer can think "done that, do not need to think about it any more." We recommend considering the topic as guidelines or practice note, heavily caveated by consideration of context and factors outside the control of the enterprise. We have experience in the main list (December 2004, public) of informing analysts that the main risk we faced was political risk. There was a buy recommendation in the market. The public notification was warranted. We have told UKEB: "*SME Alliance members are astounded as to how SMEs have been excluded from deliberations and their evidence censored, despite being preparers of accounts and clients of the professions, as well as seasoned witnesses in Parliament and international commissions*".

Scope [DCL A11-A12]

The UKEB's DCL supports an approach that it is not restricted to a specific industry, but it also notes that the Proposed Amendments were developed with banks' risk management practices in mind.

5. Do you consider that the Proposed Amendments would be suitable for non-bank organisations? Please explain. It would be helpful if you provide detailed information, including:

a) a description of potential benefits from transitioning to the Proposed Amendments;

b) a description of challenges likely to arise in implementing the Proposed Amendments and how the proposed model could be changed to accommodate those challenges; and

c) whether you have concerns about the disclosure requirements for entities that are in scope but choose not apply the Proposed Amendments?

Yes ☐ No ☐ X

Detail:

5. Consultation Paper and Impact Assessment – Proposals to revise Practice Note 19 (December 2018) was issued by the FRC and replies provided by the due date. These were published by the FRC on its website and a few weeks later taken down. SMEA evidence was included, published and taken own as part of the censorship programme that FRC adopted from that date. We have literally begged for its restoration, but to no avail. This remains outstanding. Publishing and taking down is the worst of all worlds as our members are subjected to retaliation even though there is no challenge to the content that has been accepted in courts and as evidence published in Parliament, including a number of founder members being published in Hansard witnessing to Parliamentary Commission for Banking Standards and Treasury Select Committee. In an environment of censorship (including Justice Select Committee December 2018 when, we believe, evidence did not even reach the Committee) means, at the least, an economically inefficient basis of decision making, resource allocation and investment decision. Risk cannot be evaluated or mitigation. There is no evidence that is public of a bank (or insurer) offering to mitigate damage or curtail a wrongdoer.

5.1. The set-up keeps the banks blind to their risks. Ignoring damage mitigation action exponentially increases risk, but this is treated as not mattering as what has come home to roost is ignored. UKEB says: "*Proposed Amendments were developed with banks' risk management practices in mind.*" We do not know what these practices are but we do know their effects on customers and counterparties. Blocking communications is germane. We see no reason to distinguish banks or create standards for them.

5.2. We have previously evidenced ' commented to UKEB: *"Standards must be constantly under appraisal. They are all due for review to get them back to basic principles free from prescriptive rigidity so the public can really think about the numbers and the notes. The plethora of reports that have been added are obfuscations and are neither read nor understood. The auditor's report referring to a hyperlink to the FRC website has become meaningless because the FRC web-site is a moving repository where evidence from the public is censored. A report based on moving standards is not a report (at least of the auditor)." ……."As an observation that does not fit anywhere else, the term "the objective of the standard…" has crept in. Standards are to do with statutory compliance, operation of law, proper accounting, enforcement of articles, discharge of duty, publication of the truth. There is no further "objective"."*

Level of application [DCL A13-A14]

6: The UKEB DCL supports the IASB proposal to require organisations to apply the Proposed Amendments at the level at which the organisation mitigates the re-pricing risk arising from underlying portfolios in accordance with its risk management activities. Do you agree with this position? Please explain why or why not. If your answer is no, please provide detailed information of circumstances where you foresee potential application challenges arising from this aspect of the Proposed Amendments.

Yes ☐ No ☐ X

Rationale: 6. It is impossible to evaluate the consequence of this. In Highland Financial (Commercial Court, Burton J and C of A, 2013) reference was made to maelstrom of 2008 (effect of financial crisis) and banks being allowed to re-price closing stock for a period of weeks endorsed by accounting standards and members bodies. This reduces cost of sales an increases gross profit. They "borrowed" client holdings to benefit from the revaluation as though their own. They had no mechanism to return it (same as distributing phantom profits, paying excessive bonuses and share options). It was technique of upfront profit take, with commensurate loss not booked to be spread over decades in the expectation of never paying. 6.1. UKEB needs to do a full appraisal of what is going on starting from a position of concern and rejecting any suggestion that banks and their customers should have different accounting rules.

Underlying portfolios [DCL A17-A21]

7. The UKEB's DCL notes that the Proposed Amendments are not clear as to when, or to what extent, forecast transactions can be treated as a fixed rate exposure, such as pipeline mortgages. Therefore, the UKEB requests the IASB to make this clearer in the proposed requirements [paragraphs A19 – A20 of the DCL].

Do you agree with this position? Please explain why or why not.

Yes ☐ No ☐ X

Rationale:

7. Please see replies earlier. Additionally accounting based on "forecast transactions" "pipeline" mortgages, are very abstract concepts. We suggest these are not part of financial statements as they are most subjective and uncertain. They cannot be audited meaningfully. Whether they have a role in capital adequacy evaluations or evaluation of distributable reserves is a moot point for specialist technicians.

8. Se replies to earlier. There is too much detail that is prescriptive and that is dangerous from the point of view of understanding the risk. A Board would en up hoping there is someone who knows what they are doing. However since banks are in silos and transactions are across silos there is no-one who sees the end to end picture. Auditors report on management and corporate lines and these have nothing to do with the transaction placing and profit taking. A foreign bank with UK branch has no chance of knowing what its branch profits are. Where results are booked is an art not a science.

9. Se replies to earlier.

Determining the net repricing risk exposure [DCL A22-A24]

10. Se replies to earlier. We were not party to "earlier feedback". We do know SMEs are important because those with a contract for borrowing discovered later there was an embedded secret interest rate swap which was enforced against them as though they had defaulted. This has been exposed a nauseam in court and Parliament but remained unbooked in the accounts of the scheme promoters.

Designated derivatives [DCL A25-A28]

11. Se replies to earlier. An observation that a proposal is not clear suggests the rest is clear. This needs checking. Remember the 1985 Insolvency Act needed rules to function and these were never produced. Therefore there was nothing to consolidate in 1986. We do not find much clear in this set of standards, particularly scope or explanatory narrative. We have experience teaching at senior level on financial instruments and risk from pre 1990 so we can evaluate what makes sense and can be understood.

12. Se replies to earlier.

Risk mitigation objective [DCL A29]

13. Se replies to earlier. "*The UKEB's DCL is generally supportive of the Proposed Amendments in relation to the proposed risk mitigation objective*…." Risk evaluation and mitigation and reporting is a management function not one for standard setters. There is too much conflating going on which is a worry.

Benchmark derivatives [DCL A30-A34]

14. Se replies to earlier. Inadequate clarity identified by UKEB may mean the draughtsman was not clear in their own mind. Were these standards drafted after agreement of the content and evaluation of the void that needed plugging? If not, this exercise is still needed: if starting again, what would it look like? That then creates the benchmark for evaluation of the current work (not just marginal changes).

Risk mitigation adjustment [DCL A35-A48]

15. Se replies to earlier. UKB says: "Therefore, the UKEB recommends that the IASB articulate more clearly why and how the departure from the *Conceptual Framework of Financial Reporting* is justified for the new model to achieve its objectives." Until absolute clarity is achieved there is no working drafts to take to public consultation. The work should be halted and fundamentally reappraised, maybe with more experienced workers who do not get distracted by detail.

16. Se replies to earlier.

17. Se replies to earlier.

18. Se replies to earlier.

19. Se replies to earlier.

Discontinuation of risk mitigation accounting [DCL A49-A52]

20. Se replies to earlier.

21. Se replies to earlier.

22. Se replies to earlier.

Withdrawal of IAS 39 [DCL A55]

23. Se replies to earlier. We may well be counterparties to preparers, or customers or in a hostile relationship in court. We have a deep interest in this subject. Limiting feedback to preparers has the risk of losing sight of unbooked obligations and losing the chance to mitigate. This is an academically intense subject. Ultimately the board evaluates and must be able to understand and explain.

Transition [DCL A53-A54 and A56-A60]

24. Se replies to earlier.

25. Se replies to earlier.

26. Se replies to earlier. UKEB says: *"The UKEB's DCL considers that organisations transitioning from IAS 39 to IFRS 9 should be permitted an irrevocable election to reconsider their designation of financial instruments as measured at fair value through profit or loss in accordance with IFRS 9 paragraphs 4.1.5 and 4.2.2(a)."* We consider this would make UKEB a preparer. The company must report true and fair each period and provide comparables under both policies evaluating and reporting on impact of accounting change. We simply cannot evaluate impact as required under HMGov standards for change and whether, as a package, accelerated unwarranted profit recognition will result, effectlvely state endorsed. UKEB should slow the process and take stock. When this phantom profits happens, there is no correction route.

Disclosure requirements [DCL A61-A64]

27. Se replies to earlier. UKB says: *"To improve the quality of information provided to users, the UKEB's DCL recommends that there is an explicit requirement to disclose and explain:*
the cause of the recognition of risk mitigation adjustment excess in the reporting period, if material; and
how this has affected the expected profile of the release of the risk mitigation adjustment to profit or loss.
[paragraph A63 of the DCL]". Disclosures are require by statute and public company reporting obligations. The concept of "improving the quality of information" to "users" does not apply and is not recognised under the Companies Acts; FSMA 2000; or any other reporting.

General

28. Se replies to earlier. We believe it is misleading and dangerous to adopt a piecemeal evaluation to standards. We are not confident fieldwork will help. Clear principles and separating preparers from standard setters would certainly help.

29. Se replies to earlier.

Entities that issue insurance contracts as defined in IFRS 17 Insurance Contracts [DCL A65-A67]

30. Se replies to earlier. We have dealings with most of the main insurers. There is a vacuum in claims management and at least two decades of unbooked liabilities. This is a subject of its own.

Other

31. Se replies to earlier. Banks should not have different accounting treatments to their customers and supply chain including tied agents and panel suppliers. Arguably there are instances of being in the same VAT group where financially dependent in the case of agents. Unbooked liabilities would reduce.

32. Se replies to earlier.

Response generation

Response generation 33. Did you/your organisation use a large language model (e.g. Chat GPT, Microsoft Copilot) to create any part of your/its response (response to this Invitation to Comment or a comment letter you are submitting as part of your response)?

Yes ☐ No ☐ X

If you answered yes to Question 33, please specify which model and what prompt(s) you used for the large language model.

N/A

SMEA membership appreciates the opportunity to contribute to UKEB's work and the diligence and consistency of its approach which is refreshing particularly in difficult and complex times.

SME Alliance Limited
City of London
London EC2Y
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