

## Quick Takes



### About this Newsletter

GR-NEAM's *Quick Takes* covers timely topics relevant to the insurance industry and is authored by various Enterprise Risk, Client Strategy, Investment and Accounting professionals. Each edition is designed to keep insurance executives informed on relevant topics in the industry by providing information on time sensitive issues.

### For More Information

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## Changes in Accounting for Investments Under UK GAAP

### Introduction

Change is on the way for UK GAAP reporters with FRS 102 "The Financial Reporting Standard Applicable in the UK and Republic of Ireland" being adopted by the UK Financial Reporting Council (FRC) with effect from 2015.

This means that for the 2015 year-end, syndicate accounts must be prepared under new UK GAAP, including 2014 comparatives. In order to complete this, syndicates will be required to restate their 2014 numbers (which will be under current UK GAAP). This may mean recording two sets of numbers for 2014, in order to seamlessly account for the change. This note sets out to highlight the main changes with respect to investments.

### Accounting for Investments Under FRS 102

Section 11 "Basic Financial Instruments" of FRS 102, lays out the criteria for accounting for financial assets. Basic financial instruments will be classified as Cash, Bonds, Commercial Paper and similar instruments.

A financial asset should be measured at transaction price (including transaction costs). UK GAAP reports have two choices for subsequent measurement, these being amortised cost or fair value through the profit or loss.

If the Amortised Cost Method is selected, debt instruments which meet the criteria laid out in the standard should use an Effective Interest Method to calculate the carrying value. The Effective Interest Rate is the rate which exactly discounts estimated future cash receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the Carrying Amount of the financial instrument. The Effective Interest rate is determined on the basis of the Carrying Amount of the financial asset at initial recognition.

If the Fair Value through Profit and Loss method is selected, Fair Value should be arrived at using the following hierarchy; 1) A quoted price for an identical asset in an active market; 2) A price for a recent transaction for an identical asset, as long as there has not been significant changes in economic circumstances or time changes and 3) A valuation technique.

#### **Impact for Syndicates:**

Assuming syndicates elect to report financial assets at Fair Value under Profit and Loss, there will be no significant changes in reporting. If the Amortised Cost Method is selected, it will result in no unrealised gains and losses through the Profit or Loss and a change in the Interest Income due to amortisation of the carrying value, Syndicates will be required to disclose the fair value of the assets in the notes to the financial statements.

#### **Revenue Recognition for Investments Under FRS 102**

Section 23 “Revenue”, lays out how revenue should be accounted for and more specifically in section 23.28 “Interest, royalties and dividends”, how it should be applied to financial assets.

This section states that interest shall be recognised using the Effective Interest Rate Method. As outlined above, the Interest Rate Method effectively amortises any premium/discount to the profit or loss over the life of the bond.

#### **Impact for Syndicates:**

This could have an impact for syndicates who present their interest income separately in their financial statements, even if they are recording their assets at Fair Value through Profit and Loss. They will need to record an amortised value of the security, along with the fair value, so that interest income is correctly recorded. Under current UK GAAP, interest income is recorded using an accruals method.

This also impacts unrealised/realised gains and losses as they will be calculated off this amortised cost book value rather than an original cost.

#### **Conclusion**

It is important that syndicates start planning for the impact of FRS 102 now through discussions with their auditors and Lloyd’s on any potential changes. Syndicates should also hold discussions with their investment manager to ensure any additional required reporting is available. This is especially relevant for 2014, when two sets of numbers may be required - current UK GAAP and new UK GAAP.

#### **Note:**

*Under FRS 102, Section 11 “Basic Financial Instruments”, reporters may choose to adopt IAS 39 Financial Instruments: Recognition and Measurement. For the purposes for this paper, we have chosen not to consider this option.*



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