The new financial reporting framework in the UK and Ireland is now a reality. Work needs to start immediately on making decisions and commencing implementation.

In March 2014, the Financial Reporting Council (FRC) issued FRS 103, *Insurance Contracts*, and accompanying non-mandatory implementation guidance to assist insurers in adopting the new regime. It is the fourth standard added to the suite of accounting standards by the FRC, which will fundamentally reform the financial reporting framework in the United Kingdom and Republic of Ireland. FRS 103 sets out the accounting requirements for entities that apply FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and that:

- Issue insurance contracts (including reinsurance contracts) and/or hold reinsurance contracts.
- Issue financial instruments with discretionary participation features.
Key facts

- Entities applying FRS 102 will need to apply FRS 103 for their insurance contracts.
- FRS 103 is based on IFRS 4, Insurance Contracts, FRS 27, Life Assurance and the Association of British Insurers’ Statement of Recommended Practice (ABI SORP).
- Similar to IFRS 4, FRS 103 generally allows entities to continue their existing accounting practices for insurance contracts and, in limited circumstances, allows entities to make improvements to existing accounting policies.
- For entities in scope, the new regime is effective for annual periods beginning on or after 1 January 2015, with early adoption permitted.
- FRS 103 is expected to have a limited life and the FRC expects to undertake a review once the International Accounting Standards Board (IASB) issues its updated standard on insurance contracts.

Will it affect me?

FRS 103 adopts the existing definition of an insurance contract from IFRS 4 and FRS 26, Financial Instruments: Recognition and Measurement.

Insurance contract definition: a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

The definition will be new to UK GAAP reporters that have previously not applied FRS 26 and issue insurance contracts, and management will need to assess whether the contracts it issues meet the definition of an insurance contract under the standard. Depending on what conclusions are reached, recognition and measurement differences could arise on adoption of FRS 103.

What is it based on?

FRS 103 is primarily based on IFRS 4. The FRC’s overriding objective in setting the standard was to facilitate the production of high-quality financial statements that are proportionate to the size and complexity of the reporting entity and the users’ information needs.

The FRC has also incorporated some elements of FRS 27 and the ABI SORP with respect to recognition, measurement and disclosures in the body of the standard and the implementation guidance. In particular, the requirements of FRS 27 with respect to recognition and measurement of with-profits business have been included in section 3 of FRS 103. However, most of the ABI SORP and FRS 27 requirements now form part of the non-mandatory implementation guidance.

Timetable for change

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- Opening balance sheet 1 January 2014
- Comparative year balance sheet 31 December 2014
- Financial statements for the year ended 31 December 2015
- First mandatory financial statements under the new regime
Given that transition to a new framework must take place alongside business-as-usual activities and Solvency II, planning for these mandatory changes should start now.

**What are the main differences with IFRS 4?**

- Whilst IFRS 4 does not permit catastrophe and equalisation provisions, FRS 103 permits such provisions where required by the regulations.1
- IFRS 4 permits an entity to continue measuring insurance liabilities on an undiscounted basis but does not allow an entity to choose a new policy without discounting. FRS 103 only allows discounting where required by the regulations.1
- For insurance contracts that contain a discretionary participation feature, as well as a guaranteed element, and the discretionary participation feature is recognised separately from the guaranteed element, IFRS 4 permits an insurer to classify the discretionary participation feature either as a liability or a separate component of equity. FRS 103 only allows this where permitted by the regulations.1

**How does it affect my accounting policies?**

The FRC did not intend the standard to be more onerous than IFRS 4 and, similar to IFRS 4, the standard allows entities to continue their current accounting practices but provides the flexibility to make improvements (subject to legal and regulatory requirements). However, such changes can only be made if they make the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs.

Although we expect the majority of UK insurers to continue their existing accounting policies, most will need to consider their readiness for adoption in light of the additional requirements of FRS 103 compared with current UK GAAP, such as the need to provide additional disclosures.

**What are the disclosure requirements?**

Compared with current UK GAAP, the disclosure requirements under FRS 103 will increase for both general and life insurers. As with IFRS 4, insurers will now be required to provide claims development information for the last 10 years. However a transitional relief is available on initial adoption, which allows insurers to report this information for a five-year period. In addition, insurers will also need to provide reconciliations of the movement in insurance liabilities, reinsurance assets and, where relevant, related deferred acquisition costs and other intangible assets related to insurance. The standard also requires insurers to provide the following:

- Disclosures relating to significant assumptions and the effect of changes to those assumptions
- Risk disclosures relating to insurance contracts
- Information about credit risk, liquidity risk and market risk
- Insurance sensitivity analyses
- Maturity analyses showing the estimated timing of net cash outflows.

These requirements could create considerable challenges for entities that currently do not collect the required information. In our view, an early assessment of system and process readiness is therefore essential to a seamless transition.

**What has changed since FRED 49?**

An area that has changed since the exposure draft is the accounting for insurance balances denominated in a foreign currency. Unlike IFRS and FRS 23, The Effects of Changes in Foreign Exchange Rates, FRS 103 states all assets and liabilities in a foreign currency arising from insurance contracts are monetary items for the purpose of applying FRS 102. This means that insurance assets and liabilities, including unearned premium and deferred acquisition costs, are retranslated at the closing rate. This will remove foreign exchange volatility in situations where the assets held to back insurance liabilities are also monetary items. However, it will create a GAAP difference on transition for those insurers converting to FRS 102 that had previously applied FRS 23, where unearned premium and deferred acquisition costs are considered to be non-monetary items and not retranslated after initial recognition.

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1 The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)
I am a managing agent at Lloyd’s. How is my syndicate reporting affected?

Lloyd’s syndicates will be subject to FRS 103 and will therefore face the same requirements as other insurers. However, unlike other insurers, syndicates will not be able to early adopt the new regime due to restriction proposed by Lloyd’s. This was to ensure that a consistent approach is applied by the managing agents for the purpose of Lloyd’s Aggregate Accounts each year.

Am I entering a stable reporting environment?

Not quite. Although the FRC does not intend to make any significant changes to FRS 103 in the near future, the standard is expected to have a limited life. The FRC expects to review this standard once the IASB has issued its updated standard on insurance contracts.

When is it effective?

FRS 103 is effective for annual periods beginning on or after 1 January 2015. Early adoption is permitted along with FRS 102, with the exception of Lloyd’s syndicates.

What do I need to do now?

Insurers will ultimately have a choice between FRS 102 (and FRS 103), IFRS with reduced disclosures (FRS 101) and full IFRS. Although we do not expect adoption of any of these to have a significant impact on the way in which businesses are managed, early assessment could help avoid unwanted surprises, especially for insurance companies which did not apply FRS 26 previously and will therefore need to perform a contract assessment exercise on adoption.

Insurers will also need to consider the disclosure requirements and assess system and process readiness to provide the necessary disclosures.
Why EY?

Converting away from UK or Irish GAAP means changing more than just the numbers. Early assessment is essential in order to maximise your benefits and minimise your risks.

EY has brought together teams with extensive experience of IFRS conversions, accounting, tax, pensions, distributable reserves, entity rationalisation and beyond. Our breadth of GAAP conversion experience enables us to identify issues early and quickly provide practical implementation advice.

In turn, this will allow you the time to anticipate and resolve strategic and operational issues, enabling a smooth transition.

How can EY help?

► Determine an appropriate reporting framework, depending on the entities’ size and complexity and the reporting framework of the group.
► Perform gap analysis of technical accounting differences and the resulting financial impacts, and system and data requirements.
► Plan and project manage the transition project, applying industry best practice and experience from working with other insurers.
► Draft accounting policy documentation; prepare accounting journals for adjustments and reclassifications for restated financial statements.
► Prepare draft financial statement disclosures in accordance with the adopted framework.
► Provide appropriate training to finance staff to help them transition to the new regime.

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