It's a new year and accounting change is on the horizon.

Our old friend, UK GAAP will be no more as the UK's Financial Reporting Council ("FRC") issued FRS 102 in 2013 which will replace it from 2015. All Isle of Man companies that currently use UK GAAP will have to change their accounting framework, but does that mean FRS 102 is the only option?

Why change UK GAAP?

We have known for a while that UK GAAP needed a revamp. In 2005 when the EU made it compulsory for all publicly traded groups to apply EU adopted International Financial Reporting Standards ("IFRSs"), it seemed IFRSs were heading for world domination when the FRC then started to adopt some of the IFRSs in a bid to achieve consistent accounting practices. It looked a winning strategy. However, IFRSs have been criticised for being complex which has resulted in 'onerous' disclosures. As such, the big question everyone had been asking was, how was the FRC going to bridge the gap?

When the International Accounting Standards Board ("IASB") issued the IFRSs for Small and Medium-sized Entities ("SMEs") in July 2009 it seemed the answer was here. With only 230 pages to interpret compared to nearly 3000 pages for IFRSs, it seemed more simple and, most importantly, more relevant to meet the SMEs' financial reporting needs. The FRC made some amendments to this new accounting standard to bring in some accounting treatments available under current UK GAAP, for example, the accounting policy choice to revalue fixed assets, and then FRS 102, renamed "The Financial Reporting Standard applicable in the UK and Republic of Ireland" was born at nearly 350 pages long.

But does a company have to use FRS 102?

You might ask what about subsidiaries whose results are consolidated into a group that uses IFRSs. Wouldn't it be easier for these subsidiaries to use IFRSs for recognition and measurement purposes and apply reduced disclosures? Well the FRC listened and in response issued FRS 101, "Reduced disclosure framework - Disclosure exemptions from EU-adopted IFRS for qualifying entities". But it can only be adopted by subsidiaries included in IFRS group accounts that are publicly available.

Another option could be to adopt the FRSSE, the "Financial Reporting Standard for Small Sized Entities", which so long as the company is eligible, could be a more simple solution.

Do I need to worry about this now?

The short answer is yes. FRSs 101 and 102 are effective for accounting periods beginning on or after 1 January 2015. Comparatives are required to be presented which means for a company with a 31 December year end an opening balance sheet at 1 January 2014 will have to be prepared. But don't panic if you haven't even thought about it yet, there is still time. But management should discuss this soon because there are likely to be accounting differences that will need to be understood to ensure the right accounting standard is adopted.

What are the main differences?

There are many and this article is no substitute for reading the new accounting standards in detail because the extent of the changes will depend on the individual circumstances of the company.

However, in our view, the companies expected to be affected the most under both accounting standards are financial institutions and those that have financial instruments. Financial institution has a broad definition (note – this is not the same definition used within FATCA). It includes banks, building societies, insurance companies, pensions, funds etc. Financial instruments such as derivatives will now be recognised on balance sheet at fair value (under current UK GAAP these instruments were only disclosed) with movements in fair value being recognised in profit or loss. This in turn will increase earnings volatility and may impact a company's tax and distributable

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reserves. Unquoted equity investments might now be measured at fair value and we know this can be a tricky area. To mitigate fair value measurement volatility, hedge accounting is now permitted provided the hedge documentation is in place. And finally, there will be more financial instrument risk disclosures.

The Statements of Recommended Practice ("SORPs") will continue to exist where there is a demonstrable need. But insurance companies, including captives, will have to use a new insurance accounting standard which will be named FRS 103, "Insurance contracts", if FRS 102 is adopted. FRS 103 is not expected to change current accounting practices provided the contract meets the definition of an insurance contract. As such management will have to perform a classification exercise over its existing contracts. FRS 103 is still in draft but when issued it is expected to have the same effective date as for FRS 102.

Company law

One final point to note is that FRSs 101 and 102 have some aspects of UK company law embedded into them, particularly around the presentation of the primary statements. For 1931-2004 Act companies, Isle of Man Company Law is expected to override the UK requirements. But for 2006 Act companies given the lack of current legal disclosure required by the 2006 Act we expect these companies will end up following FRS 101 or FRS 102 in its entirety i.e. the UK Companies Act requirements will apply.

Tough decision ahead

In deciding which accounting standard to adopt there are many factors to consider. We think the key points will be to understand how the new accounting standards will affect the company's tax, distributable profits, compliance with bank covenants, regulatory capital and if management have the systems and internal controls in place to capture the required data particularly where there will be new accounting or disclosure requirements. Further, we also recommend that if the company is a subsidiary, then local management should discuss the options with management of its parent company so as to minimise the efforts that will be required for statutory and group reporting.

By Wendy Jessup,
Senior Manager, PwC

For further information please call us on *689689* or email us via the contact us function at *www.pwc.co/im*

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