

**FROM:** Head of Market Reporting  
**LOCATION:** 86/G5  
**EXTENSION:** 5129  
**DATE:** 22 April 2004  
**REFERENCE:** Y3298  
**SUBJECT:** IMPACT OF FRS 5 APPLICATION NOTE G ON  
UNDERWRITING AGENTS' FINANCIAL  
STATEMENTS  
**SUBJECT AREA(S):** Solvency requirements for Underwriting Agents  
**ATTACHMENTS:** No  
**ACTION POINTS:** To be applied for financial periods ending on or after 23  
December 2003  
**DEADLINE:**

The purpose of this bulletin is to confirm that underwriting agents' financial statements for financial periods ending on or after 23 December 2003 and future QF1 and AF1 submissions must take into account the requirements of FRS 5 "Reporting the Substance of Transactions": Application Note G "Revenue Recognition" ("AN G").

AN G was issued by the Accounting Standards Board on 13 November 2003. The adoption of AN G is mandatory for all financial periods ending on or after 23 December 2003.

AN G covers revenue receivable by intermediaries from the sale of insurance products and services and therefore impacts on the recognition of fee income and profit commission. It is not intended here to provide complete guidance on the impact of AN G, this will need to be considered by each agent, with its auditors, having regard to the circumstances of the agent. In general, however, we would expect application of AN G to have the effect of deferring the recognition of a proportion of fee income over the contractual life of the relevant year of account and there may also be an acceleration of the recognition of profit commission.

The earning of profit commissions may have cash flow and solvency implications for agents. The early recognition of profit commission will create a debtor which may be due after more than one year. Agents will incur corporation tax on these commissions as they are booked in the accounts. Although the profit commissions are due in more than one year, the tax liability is due in the current year.

There will therefore be a mismatch of current assets (in terms of profit commissions due to the agents) and current liabilities (the tax liability on these commissions) and this could have an adverse impact on the net current assets solvency test.

Agents are required to prepare the return in accordance with the rules set out in the Capital and Solvency Requirements 2003.

Where this results in agents failing to meet the net current asset test, as a direct result of the profit commission asset / tax liability mismatch created through the application of AN G, agents will need to demonstrate their ability to meet their current year liabilities through the provision of cash flow forecasts, evidence of banking facilities and any other information deemed appropriate in the submitted return.

Agents will also be required to retain sufficient current resources to ensure that there is no further future failure of the net current asset test as a result of this mismatch.

Attention should be drawn to Part V (c) of the requirement for directors to sign off that adequate funds and facilities exist to enable the agent to carry on business as a going concern for a period of not less than 12 months from the date of sign off.

The auditors are required to opine on the reasonableness of the statements contained in the Directors' Declaration of the AF1 return. We would expect the auditor's work to include a review of cash flow forecasts, evidence of banking facilities and any other supporting information the directors' have used to gain comfort over statements made in the Directors' Declaration.

A number of agents have adopted AN G within the figures in their 31 December 2003 QF1 submissions but others have submitted that return on the same basis as previous returns. The figures in the 31 December 2003 AF1s, due 28 May 2004, must take account of AN G. If the financial statements submitted with the AF1 do not make reference to the impact of adopting AN G, then the covering letter should clarify how AN G has been applied.

The figures in the 31 March 2004 QF1, due 30 April 2004, must take account of AN G.

If you have any queries on this bulletin please contact Warren Brayn (extn 6701 or by e-mail [warren.brayn@lloyds.com](mailto:warren.brayn@lloyds.com)) or Robert Smith (extn 5459 or by e-mail [robert.smith@lloyds.com](mailto:robert.smith@lloyds.com)).

This market bulletin has been sent to all underwriting agents and recognised auditors.

John Parry  
Head of Market Reporting