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ICAEW Rep 5/05

Mr Ian Mackintosh
Chairman
Urgent Issues Task Force
5th floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

From the Office
of the Chief Executive

Dear Ian,

Accounting for Insurance Broker Debtors and Creditors

An issue has come to our attention regarding the current accounting treatment under UK GAAP of insurance debtor, creditor and cash balances by insurance brokers. The implementation of IFRS by certain large brokers and various developments in financial reporting, the recent regulation of brokers and the drive towards 'contract certainty' have raised questions as to whether the current established practices in this area under UK GAAP remain the most appropriate. The FSA estimates that there are around 7,000 general insurance intermediaries. A large majority of these are likely to continue to apply UK GAAP and may be affected. The issue is set out in more detail below.

Within insurance brokers' financial statements, insurance debtor and creditor balances represent premiums receivable from policyholders, claims receivable from insurers, premiums payable to insurers and claims payable to policyholders. Insurance cash balances effectively represent cash in transit between the policyholders and insurers. The current established UK accounting practice is for these balances to be included in the broker's balance sheet. These numbers can be the largest numbers on a broker's balance sheet.

The issue can be separated into two phases: (1) before any cash has been transferred; and (2) when cash is held by the broker in transit.

(1) Before any cash transfers, the insurance debtor and creditor balances do not meet the IAS 32 definition of assets and liabilities since the broker has no substantive beneficial interest in the debtor (apart from a right to its commission) and has no liability for the creditor in the event of default from the related debtor. There is no particular problem in determining whether insurance brokers act as principals or agents because contracts typically make it clear that the broker is acting as agent of the insured.

Recent developments in the regulation of insurance brokers have strengthened this position, with new requirements for insurance brokers to hold client money in trust, or to put in place explicit arrangements with insurers by which the insurer explicitly retains credit risk for any cash in transit held by the broker (known as the 'risk transfer' approach).

It appears clear that, under IFRS, the insurance debtor and creditor balances before any cash has been transferred should not appear on the balance sheets of brokers as they do not represent an asset or liability of the broker.

(2) The position when the cash is in transit may be less clear cut and might depend upon the type of trust arrangements in place or whether the risk transfer approach has been used. The amount of cash held in transit can be significant and is not immaterial to the balance sheet. Often, insurance brokers have the standard agreements with insurers which allow them to retain premium cash in transit for a period of time. It should also be noted that the brokers typically obtain the right to investment income on cash balances held.

At least two UK listed brokers have announced that they will change their accounting policies to derecognise the 'phase 1' debtor and creditor balances under IFRS. This is a different conclusion to the current treatment under UK GAAP and it is not immediately apparent why UK GAAP should provide a different answer. Furthermore, the introduction of FRS 25 brings UK GAAP closer to IFRS and raises questions as to whether the current UK GAAP treatment will remain appropriate for 31 December 2005 year ends, when elements of FRS 25 will be effective. Without guidance, there may be diverging practice in UK GAAP thereafter.

This issue appears to fall within the remit of the Urgent Issues Task Force given that: existing UK practice in this area may be lagging behind recent developments in regulation and in the accounting framework; there is evidence that the treatment under UK GAAP may be diverging; although the impact on profits might be nil, the amounts involved are significant in balance sheet terms for insurance brokers; the issue affects a large number of insurance brokers; and it is an emerging issue where urgent guidance would be helpful. We would welcome consideration to be given to the development of UITF guidance on accounting for insurance debtors, creditors and cash balances held by insurance brokers.

We would be happy to provide further information and a fuller analysis of the issues involved in due course. If you have any queries, please contact Iain Coke, the Institute's Financial Services Industries Manager (020 7920 8674) in the first instance.

Yours sincerely



Eric Anstee