



Insured Interest

Business partners to the insurance industry

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Time for consistency in brokers' financial statements

Moore Stephens' experience suggests that there are continuing inconsistencies in the manner in which brokers and intermediaries treat certain elements in their financial statements.



This may be due in part to the fact that accounting policies have been under the spotlight because an unusually high number of deals have been both mooted and concluded. But it is also indicative of a lack of clarity and consistency on such issues as income

recognition and the treatment of client balances.

It has been argued that the wider adoption of International Financial Reporting Standards in the insurance industry would help even out the inconsistencies in approach and treatment, but it is by no means certain that this would have a significant effect. All new UK accounting standards are in any case compliant with IFRS. All listed companies are required to be IFRS-compliant, but comparatively few other UK insurance entities have gone down this road. There may be advantages to doing so - such as the opportunity to uplift assets and to earn the kudos which can attend the ability to demonstrate compliance with internationally recognised standards - but it seems unlikely that this situation will change significantly in the short term. So the answers to the problems associated with inconsistencies in brokers' financial statements must be sought elsewhere.

So far as income recognition is concerned, the guidance note from the ICAEW advises companies not to include income in their accounts until they are contractually entitled to do so. But how are brokers to interpret exactly what that entitlement is - and when it should properly attach - when they are typically dealing with business which entails protracted placement negotiations and ongoing claims handling responsibilities which straddle policy years?

There is also the issue of profit commission, and indeed commission of any sort. Commission may be contingent upon a number of different events, and entitlement may be triggered at varying levels and at different times. There is certainly a wide divergence among brokers in the manner in which it is treated in the accounts.

There is sometimes very little disclosure in brokers' accounting policies about the exact manner in which income recognition is handled, beyond acknowledgment that the firm is compliant with regulations. To expand this more fully and to develop more accurate income measures, brokers may need to put in place a proper time and costs recording system, which is not the sort of thing one happens upon every day in the average broker's office.

The treatment of client balances is an area rife with inconsistency of treatment. Should they be on the balance sheet or not? If they are included, the balance sheet can look huge, and the tax implications may be problematic. UK GAAP takes the view that client balances should be on the balance sheet if the party controlling them enjoys economic benefit from them, which of course is often, but not always, the case with brokers. IFRS, meanwhile, takes the view that client balances should generally remain off the balance sheet, as fiduciary items from which no benefit is derived.

There are other issues to be factored in when assessing brokers' financial statements. For example, is the broker the agent of the assured, or of the underwriter? Where does the broker stand with regard to normal agency rules? These are questions which the industry thought, long ago, had been answered definitively. But regulation has changed since then, and perspectives have become blurred. Now may be the right time to go back and take another look at the rules, and at how they are applied in practice. If the user group is confused, what hope is there for greater consistency?

Exchange is no robbery

The Exchange Insurance Company Limited (ExCo) is the underwriting and marketing arm of the Exchange Bond, a surety bond in the form of a guarantee which acts as a substitute for the cash deposit traditionally given by buyers to vendors at the time of exchange of contracts in residential house purchases. The property vendor agrees to accept the Exchange Bond instead of cash.



Frank Speight is joint CEO of the UK-based, FSA authorised and regulated specialist insurer, which he helped establish in 2005. Frank explains, "In the UK, a seller will usually require a cash deposit of 10% of the purchase price to secure the

property at exchange of contracts. When the buyer uses an Exchange Bond, however, payment of this deposit is postponed until completion of the property purchase. The Exchange Bond guarantees the seller the full deposit amount should the buyer fail to complete the purchase.

"At completion, the buyer pays the full purchase price. Should the buyer not complete, ExCo pays the builder the deposit amount under the terms of the Exchange Bond. Exchange Insurance will then recover the deposit from the buyer. Exchange Bonds can be used by individual or corporate buyers to purchase existing

properties, new properties and, depending on location, overseas properties."

Frank is confident that the Exchange Bond will become an increasingly common feature in the UK property purchase market. He points to the example of Australia, where a similar product was first launched in 1997, and where it is now deeply embedded in the process as part of the normal house purchase procedure.

Moore Stephens acts as auditors and advisors to ExCo. Frank explains, "What you need from an accountant, firstly, is technical knowledge and understanding. It is very easy to deal with people who know what they are talking about. Secondly, you need a high level of responsive service. We get both from Moore Stephens. And they tell us what we need to know, not what we want to hear."

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FSA ponders mandatory commission disclosure

The insurance industry is facing potential onerous commission disclosure requirements following publication by the FSA of a Discussion Paper setting out concerns about 'Transparency, disclosure and conflicts of interest in the commercial insurance market'.

Evidence presented to the FSA suggests that commercial customers are being poorly informed about the cost of mediation services, in particular, contingent commissions, the extent to which intermediaries search the market, and the capacity in which intermediaries are acting.

Noting that full transparency is necessary to enable customers to operate more effectively in the market, the FSA has identified three conditions - clarity, compatibility, and accessibility. Its potential solutions involve more rigorous supervision and enforcement of existing rules and principles plus guidance and a customer education initiative, developing an enhanced 'on request' regime, and implementing mandatory disclosure.

The latter option seems to be becoming ever more likely, and with it will come a host of challenges for the insurance industry.

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VAT and comparison websites

Two recent UK VAT Tribunal decisions could have an impact on how web-based insurance services are structured and priced in the future.

The first case concerns InsuranceWide.com, which provides an online comparison website service for insurance products, putting potential customers in touch with insurers via a click-through from its website to that of an insurer or broker. It receives commission from insurers based on the number of contracts resulting from such introductions.

In the UK, insurance intermediaries are generally exempt from the payment of VAT. But the tribunal found that none of the services provided by InsuranceWide fell within the VAT exemption. Specifically, it found that InsuranceWide was not acting as either an agent or broker, or in an intermediary capacity.

The tribunal found that InsuranceWide specifically disclaimed being an agent on its website, and deemed that it was playing no part in negotiating the contracts. It also found that InsuranceWide could not claim VAT exemption as an insurance intermediary under UK law or as a provider of insurance-related services under EU law. Rather, it said that InsuranceWide was nothing more than an introducer of business, and that its role could not properly be distinguished from that of an advertiser.

HMRC says the decision in InsuranceWide is in line with published policy. It does not regard it as applying to all



internet services, and certainly not those where the necessary criteria are met.

The case of Trader Media Group Limited concerns a 'click-through' facility on the Autotrader website, which allows customers to obtain motor insurance. The circumstances are similar to those in InsuranceWide. However, on this occasion, the tribunal applied a wider definition of 'insurance agent' and agreed that TMG was more than just an introducer. The tribunal concluded that the exemption should apply. At the time of writing, HMRC have not commented on this latest case and the decision may yet be appealed. However, for the time being, the possibility of exemption for internet click-through services still exists.

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Corporate governance for mutuals

The Association of Mutual Insurers (AMI), in co-operation with the Association of Friendly Societies (AFS), has produced an updated Annotated Combined Code on Corporate Governance for Mutual Insurers.



The annotated code does not demand compliance with a set of detailed and inflexible rules. Rather, it imposes an obligation to 'comply or explain'. It represents a level of governance to which all small mutual insurers should aspire

as they grow. Nevertheless, it clearly recognises that a less onerous regime is appropriate for smaller mutuals where financial and human resources would be limiting factors in the application of the annotated code.

Accordingly, the AMI and AFS have developed guidelines which indicate those elements of the annotated code where smaller mutuals may be excluded from the 'comply or explain' regime. The AMI/AFS guidance notes, however, stress that, "Small mutual insurers should make every effort to comply with the annotated code above and beyond this 'minimum', whenever and wherever practical." And they should "apply all of the principles and report on them in the same way as other mutual insurers."

As an essential part of their adherence to the code, mutual insurers are required to include in their annual reports a governance statement relating to the principles contained in the code, in a manner that will enable members and other stakeholders to evaluate how these principles have been applied.

Publication of the code is timely in today's insurance market. Corporate governance is every bit as topical an issue for small mutuals as it is for other commercial organisations. Directors of such mutuals tend to be non-executive in nature, but they must operate within a framework which allows them to retain their non-executive status while also performing their duties in a properly regulated way. Mutual status does not absolve the need to be accountable, and transparent, in all dealings.

The importance of the AMI guidelines will not be lost on the FSA, whose philosophy may be interpreted to mean that good corporate governance equals good risk management, equals good compliance levels, equals treating customers fairly.

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News

Down under secondment

Rebecca Chewter, an audit senior in the Moore Stephens insurance team, was due to go to Australia last year, but her plans were delayed while she waited for her exam results. Now that is all behind her and she is off on secondment to Moore Stephens in Melbourne for four months.

Rebecca, who joined Moore Stephens as part of the Macnair Mason merger in 2006, is looking forward to her stint in Australia, where she expects to be working in industry sectors other than insurance. She says she will miss family and friends in London, and maybe even her insurance work a little, but she is excited by the prospect of working and living for a short time in a country which she has always wanted to visit. She will be coming back, but her planned return itinerary - via Sydney and Hong Kong - suggests that the sun is unlikely to be out in Clapham when she does finally arrive home.

BIBA aromas

Over 2,000 delegates converged on Glasgow between 30 April and 2 May for what is arguably the biggest event in the insurance broking calendar, the BIBA Conference and Exhibition, where exhibitors tried to outdo one another with ever more imaginative stands.

The theme of the Moore Stephens stand was chess, with the emphasis on strategy and tactics. Our wine aroma competition also attracted a great deal of interest, with visitors asked to sniff small glass bottles in an attempt to determine their ingredients, all of which are used in the making of wine. Guesses involving the words 'chloroform' and 'meths' were a little worrying, but all in all it was a well-attended and successful event.

Regulatory training

FSA regulations can be a minefield for the unprepared. Failure to meet the regulator's requirements can be costly in both business and financial terms.

Moore Stephens can help. We provide tailor-made training courses to help intermediaries in the insurance industry develop a clear and practical understanding of the regulatory environment. And we speak from experience. Our courses are delivered by senior professionals who have practical experience of working in the insurance industry and of advising clients on regulatory compliance.

In today's increasingly competitive and closely regulated insurance industry, training is paramount. And training must be sufficiently flexible to address specific needs. Our courses are for senior management and for general staff. For senior management, there are modules on understanding the responsibilities of Approved Persons, preparing for an Arrow Visit, evidencing training and competence, undertaking your own compliance health-check, managing and monitoring Appointed Representatives, and TCF.

For general staff, we cover the basic principles of TCF and demonstrate how it affects the role of each person within the company and within the insurance industry. We also highlight the key aspects of the FSA Insurance Conduct of Business regime and incorporates the recent changes in the sourcebook (ICOBS).

All our courses can be tailored to meet the specific requirements of individual firms. For more details contact:

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Who to contact

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Personal effects: Andy Galli



Andy Galli has recently been appointed managing director of Moore Stephens Consulting Limited, the firm's technology and business consulting arm. And a quick resume of his career thus far provides an accurate timeline to the growth and development of MSC.

Andy joined Moore Stephens in 1992, but left in 1998 to set up and maintain an internal audit function for a Lloyd's managing agency. The task completed, he was

back inside twelve months, with new contacts and new ideas on how to help develop Moore Stephens' IT consultancy offering.

In 2002, the Moore Stephens IT Consulting Group comprised eight people. Today, rebranded as Moore Stephens Consulting, it has grown to roughly eighty staff, with offices in London and New York, and representation in Melbourne.

Andy explains, "MSC has enjoyed continuous growth since 2002, fairly modest at first but then accelerating following the 2005 acquisition of Phoenix Database Technologies, which expanded our capability to build bespoke software applications. After that, we doubled in size over a fairly short period of time".

As a result of the Phoenix acquisition, MSC expanded its area of expertise to embrace the public sector, the travel industry, and the property market. But it is in insurance that MSC first made its name, and in which it continues to build on its reputation as a market leader. This has been recognised by Microsoft, who have selected MSC

as their preferred global supplier of management information solutions to the insurance industry.

Andy says, "The insurance industry is no different to any other in that it needs to track, understand and manage its information more effectively so that it can evaluate performance, plan for the future and achieve competitive advantage. The industry is now progressively recognising the genuine benefits to be derived from business intelligence solutions, and we have the experience and expertise to add real value.

"MSC is one of Microsoft's chosen partners in the recently created London Market Network, which aims to reduce the integration costs associated with deploying technological solutions to insurance industry problems. By pre-integrating their solutions, the network partners aim to reduce deployment costs and reduce risk for all London market insurance companies. Insurance has certainly come a long way since the days when it was cruelly argued that the market's idea of reducing losses was to increase deductibles."

As managing director, Andy is looking forward to helping MSC develop still further. Paying tribute to his predecessor, John Harbor, who has now become chairman, Andy says, "It is very reassuring to be able to call on John's experience in what will continue to be a very dynamic area of business."

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The devil's dictionary

The sixteenth in a series looking at classic and alternative definitions of accountancy terms.

P is for **Price/Earnings ratio (PE)**

The textbook definition

PE is a commonly used valuation measure which compares the price of a share to a company's earnings per share (EPS).

The alternative definition

Price/Earnings was devised by an Italian monk named Pacioli who dabbled in double-entry book-keeping 500 years ago in order to avoid inventing the Poincare Franc, which hadn't yet been thought of. This is not surprising since it would have taken a special kind of madness to foresee that, one day, somebody would find a use for a unit of account based on 65.5 milligrams of gold of 0.90 millesimal fineness. That figure is official: 0.90, mind.

The Poincare Franc has since been replaced for most purposes by Special Drawing Rights, which were created by the IMF in 1969 to support the Bretton Woods fixed exchange rate system which in many respects, especially all of them, was unsupportable, and still is.

Jules Poincare is often described as a polymath, but was almost certainly French. He is credited with inventing the chaos theory and with being one of the founders of topology, a board game about racehorses. He was also the first to present the Lorentz Transformations which led, inexorably, to Einstein's theory of relativity. Many think he was also the first man to hold an orange, although it has yet to be determined which came first - the fruit or the colour.

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