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# *Proforma-Gen Limited*

## Annual Report
## 31 December 2013

*Illustrative annual report with commentary prepared in accordance with the provisions of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 relating to insurers and the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business.*

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# Preface

PwC's illustrative annual report for a general insurance group, Proforma-Gen Limited, is a practical guide to the accounting framework for UK general insurers preparing their financial statements in accordance with the requirements of Schedule 3 and Schedule 6 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410") relating to insurance groups. The illustrative annual report considers accounting law, together with the requirements of relevant accounting standards, Urgent Issues Task Force Abstracts and other Generally Accepted Accounting Principles, current at the date of this publication[1]. An illustrative annual report has also been prepared for a UK long-term business insurance group under UK GAAP.

Commentary boxes throughout the publication provide the reader with explanations and guidance on the accounting requirements. In addition, they draw attention to the recommendations of the Association of British Insurers ("ABI") Statement of Recommended Practice ("SORP") on Accounting for Insurance Business, and give an indication of our understanding of the guidance provided therein. Best practice recommendations are provided where they are considered appropriate and helpful.

EU listed groups are required to prepare their consolidated financial statements using International Financial Reporting Standards ("IFRS"), rather than national GAAP. A permissive regime applies to other entities but many UK insurers are continuing to report under UK GAAP in their entity accounts, even when they are consolidated into group accounts under IFRS. Accordingly, in the short term, current UK GAAP continues to be of relevance to many UK insurers.

These illustrative financial statements reflect current UK GAAP requirements for UK general insurers. Proforma-Gen Limited has adopted FRS 26 and so also applies FRS 23 and FRS 29.

Given the advanced stage of New UK GAAP (see below) and to avoid unnecessary short-term changes, current UK GAAP is only being amended where this is considered absolutely essential and there are no changes to UK GAAP accounting pronouncements for the December 2013 year-end. However, there are some changes impacting the 'front end' of the annual reports as summarised below.

**Reporting changes for year ends from September 2013 onwards**

- **The Strategic report requirements and related amendments to the Directors' report**

The Department for Business, Innovation and Skills ('BIS') have issued legislation that will require all companies (except small companies) to prepare a strategic report in place of the current requirement for a business review. For an unquoted company the changes to a large extent move the material that would previously have been included in the business review section of the directors' report to the new strategic report without imposing substantive new requirements. Companies are no longer required to provide information in the directors' report on charitable donations, asset values or policy and practice on payment of creditors. Quoted companies will be required to provide additional information on the company's strategy, business model and the composition of the board, senior management and employees and greenhouse gases.

Proforma-Gen is required to prepare a Strategic Report. It has prepared this on the basis of a private company.

- **Directors' remuneration reports**

BIS have also issued legislation on the disclosure requirements for remuneration reports. The requirements only impact quoted companies. The remuneration report will need to be split into two sections; forward-looking on policy and backward-looking on implementation of the policy. Other changes include the disclosure of a 'single total figure' for directors' remuneration to aid greater comparability between companies.

Proforma-Gen is not required to include a remuneration report.

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[1] The accounting requirements of the UK Listing Authority's Listing Rules are not considered. Practical guidance on these Rules may be found in PwC's Manual of Accounting.

- **Corporate governance changes**

The Financial Reporting Council's (FRC) UK Corporate Governance Code 2012 (the Code) came into effect from September 2013. All premium listed companies are required to report on their compliance with the Code. Under the revised Code the directors will now need to state that the annual report is 'fair, balanced and understandable'. In addition, the audit committee report will need to disclose the 'significant issues' in preparing the financial statements. An annotated version of the Code intended to be applicable to mutual insurers has been issued by the Association of Financial Mutuals. The auditors' report for companies reporting on their compliance with the Code will now include additional company specific information on the audit scope, materiality and the audit risks.

Proforma-Gen is not required to, and has not chosen to, include a corporate governance report.

**New UK GAAP**

From 1 January 2015, existing UK GAAP is being rescinded and firms can report under either IFRS (which will remain mandatory only for the consolidated accounts of listed groups), or the new Financial Reporting Standard (FRS 102), published March 2013 replacing the existing suite of FRSs and SSAPs. A reduced disclosure regime will be available for subsidiary companies reporting under IFRS or FRS 102. Firms currently applying the Financial Reporting Standard for Small Entities (FRSSE) will be able to continue to do so. All accounts, other than those prepared under full IFRS (without reduced disclosure), will remain subject to the Companies Act requirements currently applicable to UK GAAP accounts, including the prescribed formats which, for insurers, are set out in Schedule 3 to SI 2008/410.

FRS 102 does not cover the accounting for insurance contracts and the FRC is developing a new accounting standard, FRS 103 to set out the relevant requirements. On 29 Jul 2013 the FRC issued FRED 49: Draft FRS 103 Insurance Contracts. FRED 49 is largely based on IFRS 4 and so will generally allow the continuation of existing accounting policies whilst allowing for improvements to be made. FRED 49 incorporates IFRS 4's disclosure requirements which may represent an increased reporting burden. FRED 49 is accompanied by draft implementation guidance much of which is drawn from the ABI's Statement of Recommended Practice.

The definition of an insurance contract in FRS 102 and FRED 49 is the same as that used in FRS 26. Any insurers reporting under UK GAAP that have not previously applied FRS 26 will therefore need to perform a contract classification exercise on the move to the new UK GAAP framework to determine which of the contracts they issue fall within that definition. Contracts (other than with-profits contracts) which do not transfer significant insurance risk will be accounted for as financial instruments.

In due course, the FRC intends to review the UK GAAP accounting requirements for insurance contracts in the light of the results of the IASB 'Phase II' insurance contracts project and the finalisation of Solvency II.

**Further guidance and information**

If you require further guidance on the UK law and accounting requirements affecting insurers' financial statements, the following PwC publications may be of assistance:

- Manual of Accounting – UK GAAP 2012/13, which can be ordered via http://www.pwc.co.uk/audit-assurance/publications/manual-of-accounting-uk-gaap.jhtml.
- The Insurance Annual Returns – A Guide through the Maze. Available at a cost of £100 from Anne Westcough (0207 212 5487).
- Proforma-Life Limited - Illustrative annual report under UK GAAP for a UK long term insurance group. Available from our website, http://www.pwc.com/gx/en/insurance/publications/proforma-life-limited-illustrative-group-annual-report-prepared-under-uk-gaap.jhtml.

If you wish to discuss any aspect of insurance financial reporting, please either contact the author, Mike Vickery (0117 923 4222), or your usual PwC contact.

PricewaterhouseCoopers LLP
London
November 2013

It should be borne in mind that the annual report has been prepared for illustrative purposes only and shows the disclosures and formats that might be expected for an unlisted insurance group of a size similar to Proforma-Gen Group that prepares its financial statements in accordance with Schedule 3 and Schedule 6 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410"). Accordingly, all conceivable disclosures cannot be shown and the illustrative annual report should not, therefore, be used as a checklist. The example disclosures should not be considered the only acceptable form of presentation. The form and content of each reporting entity's financial statements are the responsibility of the entity's management. Alternative presentations to those proposed in this publication may be equally acceptable if they comply with the specific disclosure requirements prescribed in UK GAAP.

These illustrative financial statements are not a substitute for reading the standards and interpretations themselves or for professional judgment as to fairness of presentation. They do not cover all possible disclosures that UK GAAP requires.

The names of the undertakings and financial information included in the annual report are used for illustration only and any resemblance to any existing undertaking is not intended. No responsibility can be accepted for loss occasioned to any person acting or refraining from action as a result of any material in this publication.

**Abbreviations used**

Source references used in the illustrative annual report are abbreviated as follows:

| | |
|---|---|
| ABI, 131 | Association of British Insurers' Statement of Recommended Practice ("ABI SORP") on Accounting for Insurance Business (December 2005), [paragraph number] |
| APB 2001/1 | The Auditing Practices Board Bulletin [reference] |
| DV | Disclosure voluntary |
| FRS 3, 14 | Financial Reporting Standard [number], [paragraph number] |
| PN20, 300 | Auditing Practices Board Practice Note [number], [paragraph number] |
| PwC | PricewaterhouseCoopers LLP |
| s415 | Section number of the Companies Act 2006 |
| ISA 700 | International Standard on Auditing (UK and Ireland) [number] |
| Sch7, 12 | Schedule number to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410"), [paragraph number] |
| Sch3, Pt II, 1 | Part II of Schedule 3 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410"), [paragraph number] |
| Sch3 BS(4) | Note on the balance sheet format within Schedule 3 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410") [number] |
| Sch3 PL(9) | Note on the profit and loss account format within Schedule 3 to The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI 2008/410") [number] |
| SI2008/410 | Statutory instrument [year/number] |
| SSAP 19, 12 | Statement of Standard Accounting Practice [number], [paragraph number] |
| Tech 02/10, 3.3 | Technical release [number/year], [paragraph number] issued by the ICAEW and ICAS |
| UITF20, 11 | Urgent Issues Task Force Abstract [number], [paragraph number] |

# Proforma-Gen Limited

(Registered Number: 00187936)

***Annual Report***
***31 December 2013***

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# *Directors and Officers*

## Directors

N Chamberlain

B Disraeli

W Gladstone

D Lloyd George

H Macmillan

W Pitt (Chairman)

## Company Secretary

S Baldwin

## Registered Office

12 Parliament Road

London

SW1 3XY

## Auditors

PricewaterhouseCoopers LLP

London

# Group strategic report for the year ended 31 December 2013

s414A

The directors present their strategic report on the group for the year ended 31 December 2013.

## Review of the business

s414C(2)(a)

The Company is an investment holding company and the principal activity of its subsidiary undertakings continues to be the transaction of general insurance business in the United Kingdom and, through a branch, in the USA. The business conducted is principally motor, accident and health, third-party liability, property and marine insurance and reinsurance.

***Results and performance***

s414C(12)

The results of the Group for the year, as set out on pages 14 and 19, show a profit on ordinary activities before tax of £145.6m (2012: Loss of £53.0m). The shareholders' funds of the Group total £814.2m (2012: £748.4m).

The performance of the Group during 2013 has produced encouraging results. The UK direct motor business continues to be the largest insurance line for the Group. Our underwriting discipline and increases in product ratings have produced a significant improvement in the underwriting result this year despite the challenging UK motor insurance environment. The accident and health insurance segment of our business has also seen a significant improvement in levels of new business following a review of our product offering and also as a result of the strengthening of our relationships with the broking community. The results of our US branch are showing signs of improvement following continued alignment of our products to meet the differing demands of the US market.

On 7 July 2013 the Company acquired the whole of the issued share capital of Dickens Limited, a motor insurer. This transaction has been accounted for as an acquisition in accordance with Financial Reporting Standard ("FRS") 6 "Acquisitions and Mergers". Details of the fair value of the net assets acquired and the consideration paid are set out in Note 17 'Acquisition'.

The strategic report would include discussion of significant matters that impact the development and performance of the business for the year.

***Business environment***

The UK and US general insurance industries are highly competitive, particularly in the retail sectors where our business is focused. Many companies offer similar coverage, giving rise to aggressive pricing structures. The impact of technology has been enormous and it is essential that we keep abreast of advances in this area, not only in relation to distribution channels but also in relation to the risk management and claims management arenas.

***Strategy***

The Group's success is dependent on the proper selection, pricing and ongoing management of the risks it accepts. In the motor insurance business, we have continued to consolidate our position. We believe it is important to retain a diversified portfolio of risks in order to achieve maximum profitability in this highly competitive marketplace. In the accident and health sector we have refocused the alignment of our products with our strong distribution network which will allow us to enhance our market share and retention levels in this sector.

The Group will continue to consolidate its position and concentrate its efforts on achieving maximum growth in its existing market segments. We aim to improve efficiency in all areas of our operations through cost reduction; more disciplined underwriting and more effective claims management. Customer service remains a top priority.

s414C(4)

***Key performance indicators ('KPIs')***

We have made significant progress throughout the year in relation to key elements of our strategy. The Board monitors the progress of the Group by reference to the following KPIs:

| | 2013 | 2012 | |
|---|---|---|---|
| Net premiums written | **£1,328.7m** | £1,290.2m | Gross premiums written less outward reinsurance in respect of insurance contracts |
| Loss ratio | **77.5%** | 87.9% | Ratio of net claims incurred to net earned premiums |
| Underwriting result | **£87.7m** | £1.7m | Balance on technical account for general business |
| Combined operating ratio | **99%** | 108% | Ratio of net claims incurred, commissions and expenses to net premiums earned |
| Return on capital employed | **10.6%** | (5.5)% | Profit for year after tax in relation to average equity shareholders' funds |
| Employee retention | **98.4%** | 98.9% | Number of employees at end of month (based on those in employment at the start of the month) averaged over 12 months |
| Policy retention rates | **80%** | 79% | Retention rates for retail products |
| Customer satisfaction | The Group remains in the top quartile of the general insurers customer satisfaction survey, conducted on an annual basis by Bench & Marks, rating agency | | |

Other than net premiums written and the balance on the technical account, the KPIs above are not defined in UK Generally Accepted Accounting Practice (GAAP) and so are non-GAAP measures.

s414C(2)(b)

## Principal risks and uncertainties

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. All policies are subject to Board approval and ongoing review by management, risk management and internal audit. Compliance with regulation, legal and ethical standards is a high priority for the Group and the compliance team and Group finance department take on an important oversight role in this regard. The Audit Committee is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The Group has developed a framework for identifying the risks that each business sector, and the Group as a whole, is exposed to and their impact on economic capital. This process is risk based and uses Individual Capital Assessment principles to manage our capital requirements and to ensure we have the financial strength and capital adequacy to support the growth of the business and to meet the requirements of policyholders, regulators and rating agencies.

The principal risks from our general insurance business arise from inaccurate pricing; fluctuations in the timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving.

In addition the Group is exposed to financial risks arising primarily from the investments that it holds. These risks are discussed in the section of this report dealing with financial instruments and risk management.
Our underwriting and reinsurance strategies are approved by the Board and communicated clearly throughout the business through policy statements and guidelines.

Sch7, 7(1)(b)

## Future developments

Although the growth of the UK economy strengthened in 2013, the risks to UK economic growth remain significant and future prospects may be influenced by developments in the eurozone. The economic environment will continue to evolve at a rapid pace over the next two to three years, making a return to the relative stability and certainty that preceded the crisis unlikely, at least in the short term. Interest rates are predicted to remain low in the short to medium term. In addition, we are expecting there will be continuing downward pressure on insurance rates and also the potential for an increase in claims frequency on certain lines of business. We plan to actively review our underwriting criteria and claims handling processes to seek to ensure profitability is maintained in difficult market conditions. This includes gaining a better understanding of our component costs, pricing and profit profile to develop a strategy to remain competitive in the market.

Overall in the coming year we aim to grow net premiums written at a rate broadly consistent with the current year whilst maintaining the combined ratio at current levels. We will continue to develop our relationships with distributors, generating new business where possible and increasing retention levels while navigating the pressure on rates and claims. The level of profitability in the coming year will, of course, be in part dependent on investment returns which remain a source of significant uncertainty in light of recent market movements.

In addition, a new European Union solvency and risk management framework for insurers, known as Solvency II, is being developed and is expected to be implemented from 1 January 2016. This will require insurers across Europe to meet further requirements in relation to solvency requirements and governance arrangements. The Group is actively involved in the development of these requirements with European and UK regulators and industry bodies. The Group is also undertaking a significant project to prepare for the implementation of these new requirements. The directors are confident that the Group will continue to meet all future regulatory capital requirements.

Our corporation tax charge benefitted from the reduction in the rate of tax from 24% to 23% from April 2013, and future tax charges will benefit from the further reductions to 20% planned over the next two years.

s414D(1)

By order of the board

s414D(1)

S Baldwin

Company Secretary

3 March 2014

**Strategic report**

From 30 September 2013 year-ends the Revised Narrative Reporting Regulations require firms to prepare a strategic report, replacing the business review in the directors' report.

S414C(2)

The report should include a review of the business containing:

- a fair review of the business of the company; and
- a description of the principal risks and uncertainties facing the company.

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Where non-GAAP numbers are disclosed, it should be clear that these differ from the GAAP numbers; the equivalent GAAP number should be disclosed; and there should be a reconciliation between the GAAP and non-GAAP numbers, together with relevant comment. This disclosure may be necessary to ensure that the annual report is fair, balanced and understandable

s414C(3)

The review is a balanced and comprehensive analysis of:

- the development and performance of the business of the company during the financial year; and
- the position of the company at the end of the year,

consistent with the size and complexity of the business.

s414C(4)

The review must, to the extent necessary for an understanding of the development, performance or position of the business of the company, include:

- analysis using financial key performance indicators; and
- where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

**General**

s414C(11)
Sch 7,1A.

Any matters required to be included in directors' report by virtue of Schedule 7 to SI 2008/410 which are considered by the directors to be of strategic importance may instead be included in the strategic report (with cross-reference being made from the directors' report).

s414C(12)

The report must, where appropriate, include references to, and additional explanations of, amounts included in the financial statements of the company.

s414C(14)

The report need not disclose any information about impending developments or matters in the course of negotiation if, in the opinion of the directors, such disclosure would be seriously prejudicial to the interests of the company.

s414A(3) & (4)

In group accounts the strategic report must be a consolidated group strategic report which may, where appropriate, give greater emphasis to the matters that are significant to the undertakings included in the consolidation, taken as a whole.

In August 2013 the Financial Reporting Council (FRC) issued an "Exposure Draft: Guidance on the Strategic Report" to provide non-mandatory guidance to preparers. Whilst the draft guidance has been written with quoted companies in mind, it may also be useful for other entities preparing strategic reports. However, the requirements in respect of strategic reports are more extensive for quoted companies and therefore certain content elements described in the draft guidance are not mandatory for companies that do not meet the definition of a quoted company.

The illustrative strategic report for Proforma-Gen Limited is provided by way of an example of the minimum requirements for a non-quoted company under the legislation. In practice, entities would generally provide a more comprehensive review with more entity specific information.

s415(2)

# Group Directors' report for the year ended 31 December 2013

**Company name and number**

**Companies House guidance**

For the accounts filed at Companies House, the company name and number should appear on one of the composite documents of the accounts such as the directors' report or balance sheet. The name and number may also be shown on any cover sheet delivered with the accounts.

s415(1)

The directors present their report and the audited financial statements for the year ended 31 December 2013.

Sch 7, 1A

From 30 September 2013 year-ends the business review in the directors' report has been replaced by the strategic report (discussed above) and a number of disclosures have been removed (including details of charitable donations, changes in asset values and policy and practice on payment of creditors) because they have been superseded, are already required elsewhere, or are not considered to provide meaningful information.

Where a company choses to set out in their strategic report information required by Schedule 7 to SI 2008/410 to be contained in the directors' report it must state in the directors' report that it has done so and in respect of which information it has done so.

Sch7, 7(1)(b)

## Future developments

Likely future developments in the business of the group are discussed in the strategic report.

## Dividends

The directors have declared or proposed the following dividends:

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Ordinary dividends | | |
| - Final proposed | 9.7 | 8.0 |
| Preference dividends paid | 4.8 | 4.8 |
| | 14.5 | 12.8 |

s416(3)

Disclosure of the recommended dividend is required.

## Directors

s416(1)(a)

The names of the current directors are listed on page 1. All held office throughout the year, with the exception of Mr N Chamberlain who was appointed a director on 14 April 2013. Mr W Churchill served as a director until his retirement on 31 March 2013.

s236(2) & (3)

s236(4) & (5)

s236(1), 234

**Qualifying third party indemnity provisions**

Disclosure is required in the directors' report if:

(a) at the time the report is approved any qualifying third party indemnity provision (whether made by the company or otherwise) is in place for the benefit of one or more of the directors; or

(b) at any time during the year any such provision was in force for the benefit of one or more persons who were then directors.

If:

(a) at the time the report is approved any qualifying third party indemnity provision made by the company is in place for the benefit of one or more directors of an associated company; or

(b) at any time during the year any such provision made by the company was in force for the benefit of one or more persons who were then directors of an associated company,

then the report must state that such a provision is (or was) in force.

A qualifying third party indemnity provision is a provision which provides (to any extent) an indemnity for a director which meets certain conditions specified within s234 Companies Act 2006. For example, the definition does not include indemnity against a fine imposed by criminal proceedings or a penalty payable to a regulatory authority in respect of non-compliance with any requirement of a regulatory nature.

## Employees

### Disabled persons

Sch7, 10(3)

Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and the appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of a disabled person should, as far as possible, be identical to that of a person who does not suffer from a disability.

### Employee involvement

Sch7, 11(3)

Consultation with employees or their representatives has continued at all levels, with the aim of ensuring that views are taken into account when decisions are made that are likely to affect their interests. All employees are aware of the financial and economic performance of their business units and of the Group as a whole, and are rewarded according to the results of both through an annual bonus scheme. Communication with all employees continues through the in-house newspaper and newsletters, briefing groups and the distribution of the annual report.

Sch7, 10(1) & 11(1)

The disclosures regarding employees are required when the average number of employees in each week during the financial year exceeds 250.

## Financial instruments and risk management

Sch7, 6(1)

Information on the use of financial instruments by the Group and its management of financial risk is disclosed in Note 1 to the financial statements. In particular the Group's exposures to price risk, credit risk and liquidity risk are separately disclosed in that note. The Group's exposure to cash flow risk is addressed under the headings of 'Credit risk', 'Liquidity risk' and 'Market risk'.

Schedule 7 to SI 2008/410 requires disclosure in the directors' report on the use of financial instruments by a company and its subsidiaries unless such information is not material for the assessment of the assets, liabilities, financial position and profit or loss. Disclosure is required of:

- financial risk management objectives and policies of the company, including the policy for hedging major forecasted transactions for which hedge accounting is used; and
- the exposure of the company and its subsidiaries to price risk, credit risk, liquidity risk and cash flow risk.

These Schedule 7 requirements overlap with the qualitative disclosure requirements of FRS 29 'Financial instruments: Disclosures' in relation to the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date. As the disclosure requirements within FRS 29 are more extensive than the Schedule 7 requirements, all disclosures relating to the risk exposures and the management of financial risk arising from financial instruments are included within Note 1 to the financial statements. It has been assumed that the requirement to disclose exposure to cash flow risk under Schedule 7 is covered by the combination of liquidity and interest rate risks disclosed within Note 1, in accordance with FRS 29. The directors' report cross-refers to these disclosures.

## Branches outside the UK

Sch7, 7(1)(d)

The Group has a branch in the USA.

Sch7, 7(1)(d)

**Branches outside the UK**
An indication must be given of the existence of branches of the company outside the UK.

**Political donations**

Sch7, 3-4

If a company has made any donation to a political party and/or independent election candidate in the EU and/or incurred any EU political expenditure exceeding in aggregate £2,000 in a financial year, it will have to disclose, for donations, the name of each political party and the total amount given in the financial year; and for EU political expenditure, the total amount incurred in the financial year. Holding companies are also required to give the relevant disclosure for each of their subsidiaries by whom any such donation or expenditure has been made or incurred. The total amount of contributions made by a company (or group of companies) to political parties outside the EU will also require disclosure (there is no threshold for these disclosures). Wholly-owned subsidiaries of a company incorporated in the UK are not required to give these disclosures.

Proforma-Gen Limited made no donations for political purposes.

**Research and development activities**

Sch7, 7(1)(c)

An indication of the activities of the company in the field of research and development should be provided in the directors' report.

Sch7, 7(1)(a)

**Post balance sheet events**
Particulars should be given of any important events affecting the company or any of its subsidiary undertakings which have occurred since the balance sheet date.

FRS 21, 11 & 21

FRS 21 requires disclosure of each material category of non-adjusting event after the balance sheet date. A decline in the market value of investments between the balance sheet date and the date when the financial statements are authorised for issue is given as an example of a non-adjusting event after the balance sheet date. The standard notes that abnormally large changes after the balance sheet date in asset prices would generally result in disclosure.

Proforma-Gen Limited has no post balance sheet events requiring disclosure.

Sch7, 8-9

**Purchase of own shares and sale of treasury shares**
Where a public company has an interest in its own shares, the directors' report should disclose the number and nominal value of shares in which the company acquired an interest during the year together with the maximum amount of such shares held during the year along with the percentage of the called-up share capital which such shares represent. The aggregate consideration paid for the purchase of such shares and the reason for the purchase should also be given. In addition the consideration for the disposal of any such shares during the year should be given. These requirements do not apply to Proforma-Gen Limited as it is a private company.

FRS 25, 33

FRS 25 requires a company's holdings of its own shares (or in respect of group accounts holdings by subsidiaries of shares of the parent) to be accounted for as a deduction from equity, rather than recorded as assets. Considerations paid or received shall be recognised directly in equity.

Sch1, 47(1)(b)

Companies preparing accounts in accordance with Schedule 1 of SI 2008/410 are required to disclose the number and aggregate nominal value of treasury shares held. This requirement has not been replicated in Schedule 3 for insurers. Insurers may wish to give this disclosure as a matter of best practice.

s418(2)

## Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) as far as each of them is aware, there is no information relevant to the audit of the Company's consolidated financial statements for the year ended 31 December 2013 of which the auditors are unaware; and

2) the director has taken all steps that he/she ought to have taken in his/her duty as a director in order to make him/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

A statement is required in the directors' report, by each of the persons who are directors at the date when the report is approved under s418(2) Companies Act 2006, concerning audit information given to auditors. They must state that:

(a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

## Auditors

Best practice

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution that they be re-appointed will be proposed at the annual general meeting.

## Statement of directors' responsibilities

APB 2010/02 (revised)

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have prepared the group and parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and the Group, and of the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;

- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, disclose with reasonable accuracy at any time the financial position of the Company and the Group, and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

APB 2001/01

The directors are responsible for the maintenance and integrity of the Group web site, www.ProformaGen.com. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

PwC

The directors' responsibilities statement is commonly included as a separate statement, within the directors' report (as is the case in these illustrative accounts) or at the end of any corporate governance statement.

APB 2001/1

Where the financial statements are published on a website, the Statement of directors' responsibilities may also include a statement that:

- the directors are responsible for the maintenance and integrity of the website; and
- legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

s419(1)

By order of the board

s419(1)

S Baldwin

Company Secretary

3 March 2014

s419(1)

The directors' report must be signed by the company secretary or a director after it has been approved by the board of directors.

The copy of the strategic report and directors' report that is delivered to the Registrar of Companies must be manually signed by the company secretary or a director.

## *Independent Auditors' report to the Members of Proforma-Gen Limited*

**ISA (UK&I) 700 (Revised), APB 2010/2 (revised)**

### Report on the financial statements

**Our opinion**
In our opinion the financial statements, defined below:

- give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2013 and of the Group's profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say below.

**What we have audited**
The Group financial statements and Parent Company financial statements (the "financial statements") for the year ended 31 December 2013, which are prepared by Proforma-Gen Limited, comprise:

- the consolidated profit and loss account;
- the statement of Group total recognised gains and losses;
- the consolidated and company balance sheets;
- the consolidated cash flow statement;
- the statement of accounting policies; and
- related notes.

The financial reporting framework that has been applied in their preparation comprises applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), having regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside as at 31 December 2013, and the effect of the movement in those provisions during the year on Group shareholders' funds, the balance on the Group general business technical account and Group profit before tax, are disclosed in accounting policy F and note 25.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

**What an audit of financial statements involves**
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Parent Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on matter prescribed by the Companies Act 2006
In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Other matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law have not been made.

We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

**Our responsibilities and those of the directors**

As explained more fully in the Directors' Responsibilities Statement set out on page 9, the directors are responsible for the preparation of the Group and Parent Company financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Parent Company financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

John Smith (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
3 March 2014

General insurers are required, by statute, to maintain provisions for certain classes of business as protection against exceptionally high loss ratios in future years. As these provisions relate to future events they would not normally be accounted for as liabilities. However, these provisions are required by Schedule 3 to be shown as liabilities within insurance company and group financial statements, under the heading "equalisation provision".

The inclusion of these provisions as liabilities in the financial statements of insurance companies and groups does not prevent the financial statements giving a true and fair view. The APB has advised that, notwithstanding that an unqualified opinion is expressed, it is appropriate for auditors to include reference to the particular legal requirements concerning equalisation provisions in their report, in order to ensure that a reader is aware that their opinion is expressed in the context of these requirements.

**APB 2001/1**

If the financial statements are to be posted on the company's website, further clarification of the respective responsibilities of directors and auditors is required. Unless the statement of directors responsibilities clearly states the directors' responsibility for the maintenance and integrity of the website; and refers to the fact that uncertainty regarding legal requirements is compounded as information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements, the following information should be included as notes:

- The maintenance and integrity of the entity's website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

These should appear under a heading "Notes" at the end of the audit opinion, i.e. after the name of the auditor, place and date.

**APB 2010/2 (revised)**

**ISA (UK&I) 700 (revised)**

The audit report above is based on the following circumstances. In other circumstances, a different form of report would be needed.

- Company presents together UK GAAP group and parent company financial statements.
- Company does not meet the Companies Act definition of a quoted company and the company does not voluntarily choose to report on the application of the UK Corporate Governance Code.
- Section 408 exemption taken for parent company's own profit and loss account.
- A statement of accounting policies is presented separately from the notes to the financial statements.
- The effect of equalisation provisions is material to the financial statements.

## *Consolidated profit and loss account for the year ended 31 December 2013*

Sch3, 1(1) (b)

### Technical account – General business

| | | Notes | 2013 | 2012 |
|---|---|---|---|---|
| | | | **£m** | **£m** |
| | **Earned premiums, net of reinsurance** | C | | |
| | **Gross premiums written** | | | |
| FRS 3, 14 | – acquisitions | | **40.3** | – |
| | – other continuing operations | | **1,440.4** | 1,288.6 |
| FRS 3, 14 | Continuing operations | | **1,480.7** | 1,288.6 |
| FRS 3, 14 | Discontinued operations | | **(5.8)** | 117.3 |
| | Gross premiums written | 2 | **1,474.9** | 1,405.9 |
| | Outward reinsurance premiums | | **(146.2)** | (115.7) |
| | Net premiums written | | **1,328.7** | 1,290.2 |
| | Change in the gross provision for unearned premiums | | **(26.3)** | 30.1 |
| | Change in the provision for unearned premiums, reinsurers' share | | **3.5** | 4.6 |
| | | | **(22.8)** | 34.7 |
| | **Earned premiums, net of reinsurance** | | **1,305.9** | 1,324.9 |
| | **Allocated investment return transferred from the non-technical account** | K, 10 | **216.7** | 202.0 |
| | **Other technical income, net of reinsurance** | 11 | **1.3** | 1.1 |
| PwC | **Total technical income** | | **1,523.9** | 1,528.0 |
| | **Claims incurred, net of reinsurance** | C | | |
| | Claims paid | | | |
| | – gross amount | | **1,135.6** | 1,131.7 |
| | – reinsurers' share | | **(140.7)** | (71.2) |
| | | | **994.9** | 1,060.5 |
| | Change in the provision for claims | | | |
| | – gross amount | | **23.3** | 123.2 |
| | – reinsurers' share | | **(6.0)** | (18.4) |
| | | | **17.3** | 104.8 |
| | **Claims incurred, net of reinsurance** | | **1,012.2** | 1,165.3 |
| | **Changes in other technical provisions, net of Reinsurance** | E | **25.4** | – |
| | **Net operating expenses** | 5 | **388.0** | 352.2 |
| | **Other technical charges, net of reinsurance** | 14 | **1.2** | - |
| | **Change in equalisation provision** | F, 25 | **9.4** | 8.8 |
| PwC | **Total technical charges** | | **1,436.2** | 1,526.3 |
| | **Balance on the technical account for general business** | | **87.7** | 1.7 |

Sch3, 1

Sch6, 32

s1165(5)

**Format of financial statements**

The profit and loss account and balance sheet of insurance companies and groups preparing financial statements under UK GAAP are required to follow the formats prescribed by Schedule 3 to SI 2008/410. An insurance group is defined as a group where the parent company is an insurance company or where:

1) the parent company's principal subsidiary undertakings are wholly or mainly insurance companies; and

2) the parent company does not itself carry on any material business apart from the acquisition, management and disposal of interests in subsidiary undertakings.

Sch3, 1, 2

PwC

Whilst Schedule 3 prescribes that items should be set out in the order and under the headings and sub-headings given in the formats, it does permit items to be disclosed in greater detail than so required. In addition the profit and loss account and balance sheet may include items not specifically covered by the standard formats. In those circumstances it may be appropriate to insert additional items to the prescribed formats.

Sch3, 9(1)

Where the format requires both gross and reinsurers' share of an amount to be given, a sub total must also be given.

**Format of profit and loss account**

ABI, 225

The Proforma-Gen Limited Group does not conduct any long-term insurance business and as such a technical account for long-term business is not produced. In circumstances where the amount of long-term business written by a general insurance company or group is not material, the ABI SORP recommends that the results should be disclosed as "other technical income" or "other technical charges" in the technical account for general business. Appropriate additional disclosure in respect of the long-term business is then required in the notes.

Sch3, 3(1)

In producing the profit and loss account, the Proforma-Gen Limited Group has taken advantage of the option to combine certain items to which lower case letters in parentheses have been assigned in the profit and loss account format prescribed by Schedule 3. Such combination is permissible if either:

1) the individual amounts are not material for the purpose of giving a true and fair view; or

2) the combination facilitates the assessment of the profit or loss of the company;

but is not permitted within the headings showing the derivation of net earned premiums or net claims incurred.

Sch3, 3(2)

Where items are so combined as a result of 2) above, the individual amounts are required to be disclosed in the notes to the financial statements.

Sch3, 10

**Technical account for general business**

All contracts that are general insurance for regulatory purposes should be included in the technical account - general business. As this requirement is based on the regulatory definition it applies to all contracts regulated as insurance, including those that are accounted for as investment contracts under FRS 26. Deposits and withdrawals in relation to such contracts are accounted for on a deposit basis and are taken directly to the balance sheet. Other income and expense movements in relation to investment contracts are reflected through the technical account – general business.

***Other technical income, net of reinsurance***

PwC

Fee income relating to investment contracts under FRS 26, should appropriately be included under the technical heading "Other technical income, net of reinsurance".

***Changes in other technical provisions, net of reinsurance***

Sch3 BS (25)

This includes any movement in the unexpired risks provision.

PwC

This may also include other movements in the carrying amount of the financial liability in relation to investment contracts (other than premiums and claims movements) where such amounts are classified in the balance sheet as 'Other technical provisions'.

*Portfolio transfers*

ABI, 56
ABI, 127

Portfolio premiums payments are amounts payable by one insurer ("the transferor") to another ("the transferee") in consideration for the latter assuming responsibility for claims arising on a portfolio of in-force business from some future date until the expiry of the policies. The payment should be accounted for as a reinsurance premium payable in the books of the transferor and as written premiums in the books of the transferee.

ABI, 55
ABI, 128
ABI, 129

Portfolio claims payments represent amounts payable in consideration for the transferee taking responsibility for the unpaid claims incurred by the transferor prior to a specified date. These payments should be accounted for as claims paid in the financial statements of the transferor. The transferee should credit the payment received to claims payable in the balance sheet.

PwC

Portfolio claims payments are generally payments under an existing contract between two companies. Where there is a new contract between an insurer and reinsurer in respect of claims payable to third parties by the insurer, payments should be accounted for as reinsurance (subject to the normal risk transfer criteria being met).

ABI, 130

Disclosure is required in the notes to the financial statements of any portfolio transfers that materially affect the transferee company's exposure to risk. Proforma-Gen Limited has not entered into any portfolio transfers during the year.

PwC

In practice, portfolio transfers may combine portfolio premium payments and portfolio claim payments. In these circumstances it will be appropriate to make an allocation of the portfolio payment between premiums and claims and then follow the prescribed treatment for each element.

*Structured settlements*

ABI, 131

When an annuity is purchased by a general insurer to meet obligations in respect of a structured settlement, the general insurance company will normally remain liable to the policyholder should the annuity provider fail. Unless this is not the case, this liability should continue to be recognised in the balance sheet. An annuity, paid by an annuity provider, which exactly matches the amount and timing of this liability should be recognised as an asset and measured at the same amount as the related obligation.

*Allocation of expenses*

Direct and indirect expenses need to be allocated according to their source between the following four categories:

ABI, 28

(a) Claims handling expenses.

ABI 99-101
Sch3 PL (4)

These will constitute part of incurred claims and will include all external and internal costs incurred in the handling of claims, including the movement on costs provided for settling IBNR claims. Separate provision of future claims handling costs should be assessed for each category of business. The future level of activity of the claims handling department should be assumed to be at present levels, unless clear evidence exists to the contrary.

Sch3 PL (8)

(b) Investment expenses and charges.

These should be included in "investment expenses and charges" in the non-technical account and will include external and internal investment costs.

Sch3 PL (6)
ABI, 20

(c) Acquisition costs.

These are reflected within net operating expenses in the technical account for general business and include direct costs, such as commissions, and indirect costs, such as advertising and the administrative expenses connected with the processing of proposals and the issuing of policies.

| | |
|---|---|
| Sch3 PL (7) | (d) Administrative expenses. |
| ABI, 21 | These costs are reflected within net operating expenses in the technical account for general business and will include costs arising from premium collection, portfolio administration and inwards and outwards reinsurance. They shall, in particular, include staff costs and depreciation provisions in respect of office furniture and equipment insofar as these do not need to be shown under acquisition costs, claims expenses or investment expenses. |
| PwC | Companies will need to allocate indirect costs such as staff costs, including directors' emoluments, and depreciation between the four headings above in a logical and consistent manner that fairly reflects the running of the business. |
| FRS 3, 4<br>ABI, 136 | ***Analysis between continuing and discontinued operations***<br>Discontinued operations comprise operations either sold or terminated and ceased within three months of the balance sheet date (or the date of approval of the financial statements if earlier). The operations must be material and discrete to qualify as discontinued. The ABI SORP clarifies that the cessation of writing a material category of a company's insurance business will constitute a discontinuance, provided the category comprises a discrete segment. |
| PwC | In these financial statements the cessation of aviation business has led to aviation business being classified as discontinued. However, the decision as to what constitutes discontinued business must be taken on a case-by-case basis. For example, in circumstances where such business was written as part of a company's overall book of London Market business, the directors may determine that this business was not a discrete segment and hence did not meet the definition of discontinued. |
| ABI, 137<br>ABI, 138 | For business in run-off, full provision should be made for costs associated with running-off the business, and obligations that have been incurred should be recognised to the extent they are not expected to be covered by future profits of the operation. Accordingly, expected future investment return not already recognised in calculating technical provisions should be taken into account in assessing additional provisions. In these circumstances the ABI SORP requires disclosure of the full amount of the additional provision and the expected future investment return which has been offset against it. It should be noted that anticipated profits on disposal of assets should not be taken into account in determining the run-off provisions. |
| FRS 3, 14<br>ABI, 228 | FRS 3 requires, as the minimum disclosure on the face of the profit and loss account, an analysis of "turnover" and "operating profit" between continuing operations, acquisitions (as a component of continuing operations) and discontinued operations. Such analysis for each of the other statutory profit and loss account items between turnover and operating profit should be given by way of a note to the financial statements, where not disclosed on the face of the profit and loss account. For insurance undertakings the ABI SORP permits the analysis to be restricted to those income and expenditure headings assigned with Arabic numerals in the profit and loss account format prescribed by Schedule 3, where the amounts concerned are material. |
| PwC | Neither "turnover" nor "operating profit" feature in the prescribed profit and loss account formats for insurance companies and no specific guidance is provided by the ABI SORP as to the definition of these items. In these financial statements turnover has been taken to equate to gross written premiums. In the absence of guidance other measures such as net written premiums or earned premiums (either gross or net) may be adopted. In these financial statements operating profit has been equated with profit on ordinary activities before "super-exceptional" items (see commentary to the non-technical account), tax and minority interests. In practice other measures are used such as the balance on the technical account, or a measure of profit excluding the change in the equalisation provision. |

ABI, 291
PwC
ABI, 293

Where technical results are determined taking into account longer-term levels of investment return, the ABI SORP gives the option of disclosing operating profit based on the longer-term level of investment return. Companies may wish to analyse this measure of operating profit between continuing and discontinued activities. This analysis would be consistent with the ABI SORP requirement that, where companies make an allocation of longer-term investment return, the segmental analysis should be performed on profit based on longer-term investment return.

## *Consolidated profit and loss account for the year ended 31 December 2013*

Sch3, 1(1) (b)

### Non-technical account

| Reference | | Notes | 2013 | 2012 |
|---|---|---|---|---|
| | | | **£m** | **£m** |
| | **Balance on the general business technical account** | | **87.7** | 1.7 |
| | Investment income | K, 10 | **261.2** | 186.7 |
| | Unrealised gains on investments | K, 10 | **31.7** | |
| | Investment expenses and charges | K, 10 | **(21.0)** | (25.6) |
| | Unrealised losses on investments | K, 10 | **–** | (17.9) |
| | Allocated investment return transferred to the general business technical account | K, 10 | **(216.7)** | (202.0) |
| | Other finance income | 33 | **2.2** | 3.3 |
| | Other income | 11 | **20.5** | 49.1 |
| | Other charges, including value adjustments | | **(20.0)** | (23.5) |
| FRS 3, 14 | Acquisitions | | **4.0** | – |
| ABI, 274, 276 | Share of operating profit of associated undertaking | | **5.5** | 9.5 |
| | Other continuing operations | | **135.5** | (5.5) |
| | | 3 | **145.0** | 4.0 |
| FRS 3, 14 | Discontinued operations | | **(4.4)** | (32.2) |
| FRS 3, 18 | Utilisation of provision for discontinued operations | | **5.0** | – |
| | **Total Group operating profit/(loss)** | | **145.6** | (28.2) |
| FRS 3, 18 | Provision for loss on discontinued operations | | **–** | (19.8) |
| FRS 3, 20 | Loss on termination of discontinued operations | | **(7.5)** | (5.0) |
| FRS 3, 18 | Utilisation of provision for loss on discontinued operation | | **7.5** | – |
| | **Profit/(Loss) on ordinary activities before tax** | 2 | **145.6** | (53.0) |
| | Tax on profit/(loss) on ordinary activities | 12 | **(54.2)** | 20.1 |
| | **Profit/(Loss) on ordinary activities after tax** | | **91.4** | (32.9) |
| Sch6, 17 | Minority interests | | **(8.7)** | (10.0) |
| | **Profit/(Loss) for the financial year** | | **82.7** | (42.9) |

| Reference | | 2013 | 2012 |
|---|---|---|---|
| ABI, 306 | **Reconciliation of Group operating profit/(loss) based on longer-term investment return to total Group operating profit/(loss)** | | |
| | Group operating profit based on longer-term investment return | **90.4** | 30.6 |
| | Short-term fluctuations in investment return | **55.2** | (58.8) |
| | **Total Group operating profit/ (loss)** | **145.6** | (28.2) |

**Non-technical account**

***Aggregation of investment gains and losses***

ABI, 309

As required by the ABI SORP, the headings for realised, and movements in unrealised, investment gains/losses in the profit and loss account include the overall gains net of losses or losses net of gains as a single figure. There is no requirement to disclose the gross amounts.

***Foreign exchange differences***

FRS 23, 52(a)

The amount of exchange differences recognised in profit or loss should be disclosed (except those arising on financial instruments measured at 'fair value through profit or loss' under FRS 26).

ABI, 219

These exchange differences should be dealt with through the non-technical account.

***Supplementary disclosure of operating profit based on the longer-term rate of return***

ABI, 306

Where technical results are reported based on the longer-term rate of return, the ABI SORP provides that supplementary disclosure may be made in the non-technical account, by way of memorandum, of the operating profit based on the longer-term level of investment return and the difference between the actual and longer-term levels of return as a result of the short-term fluctuations.

In these illustrative financial statements we have chosen to disclose this supplementary information by way of a footnote to the non-technical account. However, in circumstances where the FRS 3 analysis of operating profit is less complex, because all the operations are continuing, with no acquisitions, it may be preferable to incorporate the split of operating profit in terms of the longer-term rate of return and short-term fluctuations as a memorandum item within the main body of the non-technical account.

ABI, 307

An alternative earnings per share figure reflecting the result based on the longer-term rate of investment return may also be shown.

***Reporting of income from investments in participating interests***

FRS 9, 27

For companies producing accounts in accordance with Schedule 1, FRS 9 "Associates and Joint Ventures" requires the investor's share of its associates' and joint ventures' operating results to be included immediately after the group operating result. This requirement conflicts with the prescribed profit and loss account format for insurance companies under Schedule 3 which requires such amounts to be included in "income from participating interests" within investment income.

ABI, 276

The ABI SORP resolves the conflict by requiring insurance companies to follow the Schedule 3 format, but with disclosure of the aggregate share of profits/losses in relation to interests in associates and joint ventures as memorandum information on the face of the profit and loss account.

***Exceptional and extraordinary items***

FRS 3, 19

FRS 3 requires all exceptional items, other than those identified as "super exceptional" items (see below), to be included under the statutory headings to which they relate within the profit and loss account and to disclose separately by way of note or on the face of the profit and loss account.

FRS 3, 22

Any extraordinary profit or loss (net of tax) should be shown separately on the face of the profit or loss account, after the profit or loss on ordinary activities after taxation and minority interests but before any appropriations of profit. In practice it is not expected there will be any extraordinary items reported under FRS 3, however unusual a transaction or event may be.

PwC

Proforma-Gen Limited has no exceptional or extraordinary items.

*Treatment of “super-exceptional” items*

FRS 3, 20

Under FRS 3 there is a requirement for the three types of so called “super-exceptional” items, being:

- profits and losses on termination or sale of an operation;
- costs of a fundamental reorganisation; and
- profits or losses on disposal of fixed assets

to be disclosed separately on the face of the profit and loss account. For companies preparing accounts accordance with Schedule 1 such amounts are required to be shown after operating profit and before interest.

FRS 3, 27

There is no equivalent position in the profit and loss account format applicable to insurance companies or groups but it is industry practice to include super-exceptional items in the non-technical account immediately prior to “profit on ordinary activities before tax”. Losses arising on the discontinuance of the aviation business are disclosed in the non-technical account of Proforma-Gen Limited in this way. The investor’s share of any super-exceptional items of associated undertakings should be shown separately from the amounts for the group. The results of Proforma-Gen Limited Group’s associated undertaking do not include any “super-exceptional” items.

## *Statement of Group total recognised gains and losses for the year ended 31 December 2013*

FRS 3, 27

| | Notes | 2013 | 2012 |
|---|---|---|---|
| | | **£m** | **£m** |
| **Profit/(Loss) for the financial year** | | **82.7** | (42.9) |
| Currency translation differences | P | **(5.9)** | 4.3 |
| Actuarial (loss)/gain recognised in the pension scheme (FRS 17, 57) | 33 | **(2.9)** | (8.3) |
| Movement on deferred tax relating to pension liability (FRS 17, 71) | 33 | **(0.1)** | 0.4 |
| **Total recognised gains/ (losses) relating to the year** | | **73.8** | (46.5) |

FRS 3, 57

A statement of total recognised gains and losses ("STRGL") is required by FRS 3 in circumstances where any gains or losses are not reflected through the profit and loss account, i.e. are taken directly to reserves. If the company or group has no recognised gains or losses other than its profit or loss for the period, a statement to this effect should be given immediately below the non-technical account.

FRS 3, 29

In circumstances where a company or group has prior-year adjustments which impact reserves, the cumulative effect of the adjustments are required to be noted at the foot of the STRGL of the current period.

FRS 9, 28

Where an associate undertaking has gains and losses reported in its STRGL, or has such gains and losses when its accounts are restated on the investor's GAAP, the investor's share of such gains and losses should be included in the investor's consolidated STRGL. The amounts should be shown separately under each heading, if material, either in the statement or in a note referred to in the statement. Proforma-Gen Limited's associated undertaking has no reported gains or losses other than those reported in its profit and loss account.

FRS3, 26

FRS 3, 31a
FRS 3, 55

**Note of historical profits and losses**

Neither gains and losses of an insurance group arising on the holding or disposal of investments; nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profits and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents

**Note of historical cost profits and losses**

FRS 3, 31A

Insurance companies and groups are not required to include gains and losses arising on the holding or disposal of investments in a note of historical cost profits and losses. As a result, there will usually be no items to include in such a note.

FRS 3, 55

In addition, for the purpose of the note of historical cost profits or losses, the fair value accounting adjustments necessary under FRS 26 and hyperinflation adjustments under FRS 24 and UITF Abstract 9 are not required to be included, but this omission should be noted.

**Distributable profits – Tech 02/10 – Guidance on the determination of realised profits and losses in the context of distributions under the Companies Act 2006**

Tech 02/10, published by ICAEW and ICAS, provides guidance on identifying, interpreting and applying the principles relating to the determination of realised profits and losses for the purposes of making distributions under the Companies Act 2006.

**Tech 02/10, 3.3,**

Profits should be treated as realised only when realised in the form of cash or other assets the ultimate cash realisation of which can be assessed with reasonable certainty. This definition embraces profits and losses resulting from the recognition of changes in fair values, in accordance with relevant accounting standards, to the extent that they are readily convertible to cash.

**Tech 02/10, 3.4**

The principles of realisation set out in Tech 02/10 are relevant irrespective of whether the relevant accounts are prepared under UK GAAP or under IFRS.

**Tech 02/10, 3.5**

In assessing whether a company has a realised profit, transactions and arrangements should not be looked at in isolation. A realised profit will arise only where the overall commercial effect on the company satisfies the definition of realised profit set out in Tech 02/10. Thus a group or series of transactions or arrangements should be viewed as a whole, particularly if they are artificial, linked (whether legally or otherwise) or circular. This principle is likely to be of particular relevance for intra-group transactions.

Sch3, 1(1) (a)

# *Consolidated balance sheet as at 31 December 2013*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| | | **£m** | **£m** |
| **Assets** | | | |
| **Intangible assets** | | | |
| Goodwill | H, 14 | **27.3** | – |
| **Investments** | I, J | | |
| Land and buildings | 15 | **130.4** | 115.6 |
| Investments in participating interests | 16 | **36.5** | 34.7 |
| Other financial investments | 18 | **2,590.1** | 2,436.8 |
| Deposits with ceding undertakings | | **10.9** | 11.8 |
| | | **2,767.9** | 2,598.9 |
| **Reinsurers' share of technical provisions** | | | |
| Provision for unearned premiums | C | **43.0** | 39.5 |
| Claims outstanding | C, D | **267.5** | 259.4 |
| | | **310.5** | 298.9 |
| **Debtors** | | | |
| Debtors arising out of direct insurance operations | | | |
| - policyholders | | **91.6** | 75.8 |
| - intermediaries | | **322.8** | 288.2 |
| Debtors arising out of reinsurance operations | | **211.2** | 182.1 |
| Other debtors | | **213.2** | 229.9 |
| | | **838.8** | 776.0 |
| **Other assets** | | | |
| Tangible assets | M, 19 | **19.4** | 20.6 |
| Cash at bank and in hand | | **78.1** | 94.0 |
| | | **97.5** | 114.6 |
| **Prepayments and accrued income** | | | |
| Accrued interest and rent | | **32.1** | 29.3 |
| Deferred acquisition costs | 20 | **143.5** | 129.2 |
| Other prepayments and accrued income | | **2.4** | 6.0 |
| | | **178.0** | 164.5 |
| **Total assets** | | **4,220.0** | 3,952.9 |

| | | Notes | 2013 | 2012 |
|---|---|---|---|---|
| | | | **£m** | **£m** |
| | **Liabilities** | | | |
| | **Capital and reserves** | | | |
| | Called up share capital | 21 | **486.7** | 486.7 |
| | Share premium account | 22 | **17.8** | 17.8 |
| | Profit and loss account | 22 | **309.7** | 243.9 |
| | Total shareholders' funds | 23 | **814.2** | 748.4 |
| Sch6, 17 | **Minority interests** | | **65.8** | 57.1 |
| | **Technical provisions** | | | |
| | Provision for unearned premiums | C | **733.6** | 685.6 |
| | Claims outstanding | C, D, 24 | **1,991.0** | 1,928.6 |
| | Equalisation provision | F, 25 | **20.2** | 10.2 |
| | Other technical provisions | E, G, 26 | **85.2** | 59.8 |
| | | | **2,830.0** | 2,684.2 |
| | **Provisions for other risks and charges** | N, 27 | **63.5** | 52.5 |
| | **Deposits received from reinsurers** | | **5.8** | 6.2 |
| | **Creditors** | | | |
| | Creditors arising out of direct insurance operations | | **128.5** | 140.0 |
| | Creditors arising out of reinsurance insurance operations | | **49.4** | 60.3 |
| | Debenture loans | G, 28 | **95.0** | 95.0 |
| | Amounts owed to credit institutions | G, 28 | **83.8** | 77.4 |
| | Other creditors including taxation and social security | 29 | **55.9** | 11.1 |
| | | | **412.6** | 383.8 |
| | **Accruals and deferred income** | | **20.0** | 12.5 |
| | **Total liabilities excluding pension liability** | | **4,211.9** | 3,944.7 |
| FRS 17, 47 | **Pension liability** | O, 33 | **8.1** | 8.2 |
| | **Total liabilities** | | **4,220.0** | 3,952.9 |

**Consolidated balance sheet**

Sch3, 3

***Format of balance sheet***

As with the profit and loss account (refer to commentary thereon), Proforma-Gen Limited has taken advantage of the option to combine certain items in the balance sheet to which Arabic numbers have been assigned in the balance sheet format. Such aggregation is not permissible in respect of items relating to technical provisions and the reinsurers' share of technical provisions.

Sch3 BS(1)

***Called up share capital not paid***

Proforma-Gen Limited does not have any called up share capital not paid. Where applicable, however, this asset may be disclosed either as the first asset category in the balance sheet or may be included under debtors.

***Other assets***

Sch3 BS (15)

Significant amounts included under the heading "other assets" and the sub-heading "other" should be analysed in the notes to the financial statements.

***Reinsurers' share of technical provisions and deferred acquisition costs ("DAC")***

Sch3 BS (12), (17)
ABI, 135

Schedule 3 permits DAC and reinsurers' share of technical provisions to be either shown as assets or netted from unearned premiums and technical provisions respectively. The ABI SORP, in line with the requirements of FRS 5, "Reporting the Substance of Transactions", which prohibits the netting of assets and liabilities, requires that these items are shown separately as assets.

***Debtors/Creditors arising out of insurance/reinsurance operations***

PwC

Debtors and creditors are required to be split between direct insurance and reinsurance operations, though it is not clear from the Schedule 3 what is meant in this context by "reinsurance operations". We have followed the treatment adopted in insurance annual returns and interpreted debtors and creditors arising out of reinsurance operations to include balances arising from both reinsurance accepted and ceded.

***Financial liabilities in relation to investment contracts***

PwC

Financial liabilities for investment contracts, in respect of general insurance business, could be included within the headings "Other technical provisions" or "Other creditors including tax and social security" within the Schedule 3 formats. Alternatively a case may be made for creating a new line for financial liabilities in respect of investment contracts within the balance sheet format, as permitted by paragraph 2(2) of Schedule 3, on the grounds that they are not "specifically included" in any of the existing captions. Proforma-Gen Limited has included such liabilities under "Other technical provisions".

***Recoveries under investment contracts***

PwC

Amounts recoverable under contracts that are legally the form of reinsurance but are accounted for as financial assets under FRS 26 could appropriately be included within "Other financial investments". Proforma-Gen Limited has no such balances.

***Unexpired risks provision***

Sch3, BS(25)
ABI, 117

Where appropriate the unexpired risks provision should be included as part of other technical provisions and, if it is significant, it should be disclosed separately either in the balance sheet or in the notes to the financial statements.

***Bad debt provisions***

Sch3, 40(2)

Schedule 3 specifies that assets included under debtors (i.e. debtors arising out of direct insurance operations, debtors arising out of reinsurance operations and other debtors) be shown at net realisable value. Accordingly, any provisions against reinsurance recoverables should be netted off against the associated reinsurance debts.

Sch1, 1(1) (a)

# *Balance sheet of the Company as at 31 December 2013*

| | Notes | 2013 | 2012 |
|---|---|---|---|
| | | **£m** | **£m** |
| **Fixed assets** | | | |
| **Investments** | | | |
| Investment in Group undertakings | I, 16 | **705.7** | 651.6 |
| **Current assets** | | | |
| **Debtors** | | | |
| Amounts owed by Group undertakings | | **17.1** | 6.4 |
| Other debtors | | **23.7** | 29.2 |
| | | **40.8** | 35.6 |
| **Creditors: amounts falling due within one year** | | | |
| Amounts owed to Group undertakings | | **(3.8)** | (17.7) |
| Other creditors including taxation and social security | 29 | **(3.5)** | (8.1) |
| | | **(7.3)** | (25.8) |
| **Net current assets** | | **33.5** | 9.8 |
| **Total assets less current liabilities** | | **739.2** | 661.4 |
| **Creditors: amount falling due after more than one year** | | | |
| Bank loans and overdrafts | 28 | **(58.9)** | (54.1) |
| Preference shares | 28 | **(60.0)** | (60.0) |
| | | **(118.9)** | (114.1) |
| | | **620.3** | 547.3 |
| **Capital and reserves** | | | |
| Called up share capital | 21 | **486.7** | 486.7 |
| Share premium account | 22 | **17.8** | 17.8 |
| Profit and loss account | 22 | **115.8** | 42.8 |
| **Total shareholders' fund** | | **620.3** | 547.3 |

s433(1)

The financial statements on pages 14 to 114 were approved by the Board of Directors on 3 March 2014 and were signed on its behalf by:

W Pitt
Chairman

Where the holding company is not itself an insurance company, as is the case here, its balance sheet should be prepared in accordance with Schedule 1, not Schedule 3, to SI 2008/410.

FRS 1

## *Consolidated cash flow statement for the year ended 31 December 2013*

| Reference | | Notes | 2013 | 2012 |
|---|---|---|---|---|
| | | | **£m** | **£m** |
| FRS 1, 7 | **Net cash inflow from operating activities** | 30 | **50.5** | 84.6 |
| FRS 1, 7 | **Dividends from associates** | | **3.7** | 1.9 |
| FRS 1, 7 | **Returns on investments and servicing of finance** | | | |
| FRS 1, 15 | Interest paid | | **(8.7)** | (8.2) |
| FRS 1, 15 | Dividends paid by subsidiaries to minorities | | **–** | (1.0) |
| FRS 1, 15 | Non-equity dividends paid | | **(4.8)** | (4.8) |
| | | | **(13.5)** | (14.0) |
| FRS 1, 7 | **Taxation paid** | | **(1.8)** | (5.8) |
| FRS 1, 7 | **Capital expenditure** | | | |
| FRS 1, 21 | Payments to acquire tangible assets | | **(16.6)** | (16.3) |
| FRS 1, 20 | Receipts from sale of tangible assets | | **3.4** | 4.2 |
| | | | **(13.2)** | (12.1) |
| FRS 1, 7 | **Acquisitions** | | | |
| FRS 1, 24(A) | Acquisitions of subsidiary undertaking | 31 | **(79.9)** | – |
| | Net cash acquired with subsidiary | 31 | **0.3** | – |
| | | | **(79.6)** | – |
| FRS 1, 7 | **Equity dividends paid to shareholders** | | **(8.0)** | (14.6) |
| FRS 1, 7 | **Financing** | | | |
| FRS 1, 30 | Increase in borrowings | 32 (a) | **6.4** | 8.2 |
| | **Net cash (outflow)/inflow** | | **(55.5)** | 48.2 |
| FRS 1, 35 | **Cash flows were (applied)/invested as follows:** | | | |
| | (Decrease)/Increase in cash holdings | 32 (a) | **(15.9)** | 23.7 |
| | **Net portfolio investment** | | | |
| | Shares and other variable-yield securities | 32 (c) | **(84.7)** | (17.5) |
| | Debt securities and other fixed income securities | 32 (c) | **(10.7)** | 17.4 |
| | Investment properties | 32 (c) | **3.4** | 11.7 |
| | Deposits with credit institutions | 32 (c) | **52.4** | 12.9 |
| | | | **(39.6)** | 24.5 |
| | **Net (application)/investment of cash flows** | | **(55.5)** | 48.2 |

FRS 1, 12

A reconciliation between operating profit and the net cash flow from operating activities should be presented, either adjoining the cash flow statement or as a note. In the accounts of the Proforma-Gen Group, the reconciliation is provided in Note 30. Where presented immediately following the cash flow statement, it should be clearly labelled and kept separate.

FRS 1, 35

Instead of the normal requirement to include a section in the cash flow statement relating to the “management of liquid resources”, insurance companies or groups are required to include a section relating to “portfolio investments”. This format recognises the special nature of insurance business, in particular the importance of generating resources for investment to meet provision requirements for future claims and reserve requirements for solvency.

FRS 1, 35

In view of the fact that the balance sheet format in Schedule 3 does not distinguish between fixed and current assets, an analysis of the movement in portfolio investments less financing is required, instead of the normal requirement to analyse the movement in net debt. This reconciliation is not intended to form part of the cash flow statement and accordingly, where presented immediately following the cash flow statement, it should be clearly labelled and kept separate.

Sch3, 61

## *Statement of accounting policies*

**FRS 18 'Accounting policies'**

FRS 18

FRS 18 sets out the principles to be followed in selecting accounting policies and the disclosures needed to help users to understand the accounting policies adopted and how they have been applied. FRS 18 distinguishes between accounting policies and estimation techniques:

FRS 18, 4

Accounting policies are those principles, bases, conventions, rules and practices applied by an entity that specify how the effects of transactions and other events are to be reflected in its financial statements through

(i) recognising;
(ii) selecting measurement bases for; and
(iii) presenting;

assets, liabilities, gains, losses and changes to shareholders' funds. Accounting policies do not include estimation techniques.

Accounting policies define the process whereby transactions and other events are reflected in financial statements.

FRS 18, 4

Estimation techniques are the methods adopted by an entity to arrive at estimated monetary amounts, corresponding to the measurement bases selected, for assets, liabilities, gains, losses and changes to shareholders' funds.

Estimation techniques implement the measurement aspects of accounting policies. An accounting policy will specify the basis on which an item is to be measured; where there is uncertainty over the monetary amount corresponding to that basis, the amount will be arrived at by using an estimation technique.

FRS 18, 14-17

Accounting policies should be consistent with accounting standards, UITF Abstracts and companies' legislation. Where this requirement allows a choice, the FRS requires an entity to select those accounting policies judged to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.

FRS 18, 30-31

An entity should judge the appropriateness of accounting policies to its particular circumstances against the objectives of relevance, reliability, comparability and understandability. The constraints that an entity should take into account are the need to balance the different objectives, and the need to balance the cost of providing information with the likely benefit of such information to users of the entity's financial statements.

FRS 18, 51

Where it is necessary to choose between estimation techniques, an entity should select whichever of those estimation techniques is judged by the entity to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.

FRS 18, 45

An entity's accounting policies should be reviewed regularly to ensure that they remain the most appropriate to its particular circumstances. An entity should implement a new accounting policy if it is judged more appropriate to the entity's particular circumstances than the present accounting policy.

***Disclosure requirements***

FRS 18, 55

The FRS requires specific disclosures about the accounting policies followed and changes to those policies. The following information should be disclosed:

FRS 18, 51

(a) a description of each of the accounting policies that is material in the context of the financial statements;
(b) a description of those estimation techniques adopted that are significant;

(c) details of any changes to the accounting policies that were followed in preparing financial statements for the preceding period, including:

  (i) an explanation of why each new accounting policy is thought more appropriate;
  (ii) where practicable, the effect of a prior period adjustment on the results for the preceding period, in accordance with FRS 3; and
  (iii) where practicable, an indication of the effect of a change in accounting policy on the results for the current period.

  Where it is not practicable to make the disclosures described in (ii) or (iii), that fact, together with the reasons, should be stated; and

(d) where the effect of a change to an estimation technique is material, a description of the change and, where practicable, the effect on the results for the current period.

**FRS 18, 58**

Where an entity's financial statements fall within the scope of a SORP, the entity should state the title of the SORP and whether its financial statements have been prepared in accordance with the provisions of the SORPs currently in effect. In the event of a departure, disclosure is required of how the financial statements depart from the recommended practice set out in the SORP. This disclosure should include:

(a) for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances; and
(b) details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided.

**FRS 18, 62**

For any material departure from the requirements of an accounting standard, a UITF Abstract or companies legislation, particulars of the departure, the reasons for it and its effect should be disclosed. The disclosure should include:

(a) a clear statement that there has been a departure from the requirements of an accounting standard, a UITF Abstract or companies' legislation, and that the departure is necessary to give a true and fair view;
(b) a statement of the treatment that the accounting standard, UITF Abstract or companies legislation would normally require in the circumstances and a description of the treatment actually adopted;
(c) a statement of why the treatment prescribed would not give a true and fair view; and
(d) a description of how the position shown in the financial statements is different as a result of the departure, normally with quantification. Quantification is not required where it is already evident in the financial statements themselves or where the effect cannot reasonably be quantified, in which case the circumstances should be explained.

***Estimation techniques***

Clearly in the case of insurance there is often uncertainty over the monetary amount corresponding to the recognition and measurement of claims. Accordingly the requirements of FRS 18 in connection with estimation techniques are of particular relevance to insurers. FRS 18 requires:

**FRS 18, 50**

- That where estimation techniques are required to enable the accounting policies adopted to be applied, an entity should select estimation techniques that enable its financial statements to give a true and fair view and are consistent with the requirements of accounting standards, UITF Abstracts and companies legislation.

**FRS 18, 51**

- Where it is necessary to choose between estimation techniques that satisfy these conditions, an entity should select whichever of those estimation techniques is judged by the entity to be most appropriate to its particular circumstances for the purposes of giving a true and fair view.

**FRS 18, 55b**

- Description of those estimation techniques that are significant. This is considered further below.

**FRS 18, 57**
**ABI, 244**

- Where the effect of a change to an estimation technique is material, a description of the change and, where practicable, the effect on the results for the current period. This is considered further below.

FRS 18 paragraph 57 explains that:

FRS 18, 57
ABI, 243

- Although many estimation techniques are used in preparing financial statements, most do not require disclosure because, in most instances, the monetary amounts that might reasonably be ascribed to an item will fall within a relatively narrow range. An estimation technique is significant for the purposes of paragraph 55 (b) only if the range of reasonable monetary amounts is so large that the use of a different amount from within that range could materially affect the view shown by the entity's financial statements.
- To judge whether disclosures are required in respect of a particular estimation technique, an entity will consider the impact of varying the assumptions underlying that technique.
- The description of a significant estimation technique will include details of those underlying assumptions to which the monetary amount is particularly sensitive.

PwC

In respect of general insurance business, the estimation techniques for determining the provision for outstanding claims are likely to be significant. Accordingly, FRS 18 requires a description of the estimation techniques employed including details as to those individual underlying assumptions to which the claims provisions amounts are particularly sensitive.

It may be necessary for general insurers in specific circumstances to give further details of the estimation techniques used to set their claims provisions and the assumptions used/factors taken into account in determining the overall level of claims provisions. Where there is significant uncertainty, or the impact on the financial statements is significant, greater disclosure is likely to be appropriate.

The ABI SORP provides guidance on the disclosure of uncertainties and estimation techniques in respect of insurance contracts.

ABI, 239, 242

There is inherent uncertainty in estimating many of the technical provisions in respect of liabilities arising from insurance business. They can be classified as:

- general uncertainties with "normal" ranges of outcomes. These should be described in the accounting policies and periodically reviewed;
- specific uncertainties which are material and subject to an unusually wide ranges of outcomes. When the possibility of a range of outcomes is outside the "normal" range, separate disclosure should be made. Disclosure should include the circumstances, indication of uncertainties, amount and timing of the outflows and the possibility of any related reimbursements;
- uncertainties in areas where FRS 12 does not require a provision to be established but where that standard may require contingent liability disclosure.

ABI, 240

FRS 18 requires the following disclosures in the accounts:

- a broad description of the factors giving rise to the uncertainty;
- a description of those items to which significant estimation techniques have been applied;
- a description of the estimation techniques used;
- details of the significant assumptions made and information used in forming the estimates; and
- a note of those factors to which the estimation technique is particularly sensitive.

ABI, 245-247

Provisions, contingent liabilities and contingent assets arising from insurance contracts with policyholders are exempt from the requirements of FRS 12 and, in the majority of circumstances, the level of disclosure required by FRS 18 will be appropriate. However, where a specific material contingent liability exists in respect of which no provision has been made in the financial statements, and the prospect of this resulting in a transfer of economic benefits is more than remote, it will be appropriate to give the level of disclosure that would be required by paragraph 91 of FRS 12.

## A Basis of presentation

SI2008/410, 9(4)
FRS 18, 58

The Group financial statements have been prepared under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance groups and in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005, as amended in December 2006.

Sch3, 62

The financial statements have been prepared in accordance with applicable accounting standards. A summary of the more important Group accounting policies is set out below, together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

Compliance with Statement of Standard Accounting Practice ("SSAP") 19, "Accounting for Investment Properties" requires departure from the requirements of the Companies Act 2006 relating to depreciation and an explanation of the departure is given in Accounting policy I relating to investments below.

FRS 18, 55

Following a change in accounting policy, a brief explanation is required of why each new accounting policy is thought to be more appropriate, and, where practicable, an indication of the effect of a change in accounting policy on the results for the current period. If it is not practicable to make this disclosure, that fact, together with the reasons, should be stated.

FRS 3, 29

The amounts for the corresponding period should be restated on the basis of the new policy and the effect on the results for the preceding period should be disclosed where practicable. Where it is not practicable to make this disclosure, that fact, together with the reasons, should be stated.

FRS 18, 55

Where the effect of a change to an estimation technique is material, a description of the change and, where practicable, the effect on the results for the current period should be disclosed.

FRS 18, 54

A change to an estimation technique should not be accounted for as a prior period adjustment, unless it represents the correction of a fundamental error or the change is required to be accounted for as a prior period adjustment by another accounting standard, a UITF Abstract or companies' legislation.

## B Basis of consolidation

ABI, 270

The consolidated financial statements incorporate the assets, liabilities and results of the Company and its subsidiary undertakings drawn up to 31 December each year. The results of subsidiary undertakings acquired or sold during the period are included in the consolidated results from the date of acquisition or up to the date of disposal. On the acquisition of a subsidiary undertaking, all of its assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date.

ABI, 274

Associated undertakings are companies other than subsidiary undertakings in which the Group holds 20% or more of the equity share capital for the long-term and over which the Group exercises significant influence. Associated undertakings are accounted for using the equity method of accounting.

**Interests in associates and joint ventures**

ABI, 272

The ABI SORP gives guidance on the accounting treatment of interests in associates and joint ventures. Such interests forming part of an investment portfolio within the meaning of paragraph 50 of FRS 9 should be included in the financial statements of both the parent undertaking and the group as investments in the same way as other investments within the portfolio.

ABI, 273

In the case of the Proforma-Gen Group, the interest in its associated undertaking is an operational interest. The ABI SORP states that such interests should be accounted for in the parent undertaking's and the group's balance sheet using the prescribed caption "investments in group undertakings and participating interests". In the group balance sheet the valuation method which is adopted is the equity or gross equity basis as required by FRS 9.

ABI, 276

As noted in the commentary on the non-technical account, the Schedule 3 requirements in respect of the profit and loss account presentation are at odds with the FRS 9 requirements. Insurers should therefore include the amounts in the profit and loss account under 'Investment income: income from participating interests' and disclose as a memorandum item in the non-technical account the amount of the group operating result attributable to the share of operating results of associates and joint ventures.

## C Basis of accounting

**Insurance and investment contracts – classification**

The Group issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur. The majority of the Group's insurance products are classified as insurance contracts.

Investment contracts are those contracts that transfer financial risk with no significant insurance risk. Certain group healthcare products, where premiums are retrospectively adjusted taking into account claims experience, do not transfer significant insurance risk and are classified as investment contracts.

FRS 26, 2(e)

FRS 26 does not apply to rights and obligations under insurance contracts. The definition of an insurance contract and the associated guidance from IFRS 4 'Insurance contracts' have been included in Appendix C to FRS 26. Under FRS 26 insurance products have to be classified between insurance contracts and investment contracts (being those policies issued that do not meet the definition of an insurance contract). The measurement requirements of FRS 26 apply to investment contracts whereas insurance contracts continue to follow the existing provisions of the ABI SORP to determine accounting treatments. The disclosure requirements of FRS 29 will apply to all investment contracts.

**Insurance contracts**

ABI, 83

The annual basis of accounting must be used for all general insurance business, despite the fact that this will normally require some estimation to be made at the balance sheet date.

The results are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

(a) Premiums written

ABI, 84, 92
ABI, 87, 88

Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified to the company, less an allowance for cancellations.

ABI, 93

Written premiums should exclude insurance premium taxes, with any unpaid taxes included within other creditors in the balance sheet.

ABI, 89, 90

Where written premiums are subject to subsequent adjustment, reductions should be made as soon as they can be foreseen, however, potential increases should not be recognised until the amount can be determined with reasonable certainty. Additional or return premiums should be treated as adjustments to the initial premiums.

ABI, 84

If a general insurer sells business via an intermediary and is contractually entitled to receive the premium from the policyholder, then this should be recorded as written premiums. However, if the intermediary is responsible for setting the amount charged to the policyholder without reference to the insurer, then the amount payable to the insurer is recorded as written premiums and grossing-up for commission is inappropriate unless it reflects the contractual position.

ABI, 162

Premiums written do not include premiums in relation to investment contracts under FRS 26. Deposit accounting is used for such investment contracts which involves recognising the consideration received as a liability rather than as revenue.

(b) Unearned premiums

ABI, 91, 92

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

ABI, 91

ABI, 90

Written premiums should be recognised as earned income over the period of the policy having regard to the incidence of risk. The ABI SORP notes that time apportionment will normally be an appropriate method unless there is a marked unevenness in the incidence of risk over the period of cover. Where a claims event causes a reinstatement premium to be paid, the recognition of the reinstatement premium and the effect on the initial premium should reflect the respective incidence of risk attaching to those premiums.

ABI, 132
Sch3 BS (17)

(c) Acquisition costs

Acquisition costs which represent commission and other related expenses are deferred over the period in which the related premiums are earned.

ABI, 135

Related reinsurance commissions receivable should not be netted against DAC but should be included within accruals and deferred income.

ABI, 133

Advertising costs should not be deferred unless they relate directly to the acquisition of new business.

UITF 34, 3

The provisions of UITF 34 relating to pre-contract costs do not apply to the costs of acquiring insurance policies in the financial statements of insurance entities.

(d) Claims incurred

Sch3 PL (4)
ABI, 101

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

(e) Claims provisions and related reinsurance recoveries

Sch3, 53(2)
Sch3 BS (22)
ABI, 102, 94
ABI, 31
ABI, 101

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the company. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries. The company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of claims incurred but not reported ("IBNR") is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the company, where more information about the claim event is generally available. Claims IBNR may often not be apparent to the insured until many years after the event giving rise to the claims has happened. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final

outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the claim event tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the company uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in company processes which might accelerate or slow down the development and/or recording of paid or incurred claims compare with the statistics from previous periods;
- changes in the legal environment;
- the effects of inflation;
- changes in the mix of business;
- the impact of large losses; and
- movements in industry benchmarks.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these the company has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous period.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible the company adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Provisions are calculated gross of any reinsurance recoveries.

**Property, aviation and accident business**
Property, aviation and accident business is “short tail”, that is there is not a significant delay between the occurrence of the claim and the claim being reported to the company. The costs of claims notified to the company at the balance sheet date are estimated on a case by case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics which show how estimates of claims incurred in previous periods have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

**Healthcare business**
All healthcare contracts classified as insurance contracts are short tail. The total cost of claims paid by the company at the balance sheet date is used to project the expected total cost for claims incurred by reference to statistics which show how the total cost of claims paid in previous periods have developed over time.

**Motor business**
The estimated cost of motor claims excluding the cost of personal injury claims is calculated by reference to the projected number of claims, based on statistics showing how the number of notified claims has been developed over time, and the anticipated average cost per claim, based on historical levels adjusted to allow for movements in the variables described above. The personal injury element of motor claims costs is estimated using the same method as used for liability claims described below. In addition the estimate is assessed in the context of the historical development of paid and incurred claims and the implied loss ratios for each accident year.

**Liability and marine**

These claims are longer tail than for those of the other classes of business described above and so a larger element of the claims provision relates to incurred but not reported claims. Claims estimates for marine and liability business are derived from a combination of loss ratio based estimates and an estimate based upon actual claims experience using a predetermined formula whereby greater weight is given to actual claims experience as time passes. The initial estimate of the loss ratio based on the experience of previous years adjusted for factors such as premium rate changes and claims inflation, and on the anticipated market experience, is an important assumption in this estimation technique. In respect of liability claims, the assessment of claims inflation and anticipated market experience is particularly sensitive to the level of court awards and to the development of legal precedent on matters of contract and tort. The liability class of business is also subject to the emergence of new types of latent claims but no allowance is included for this as at the balance sheet date.

**Pollution**

There may be a long delay between the occurrence and notification of these types of claim. In estimating the cost of claims the company considers the type of risks written historically that may give rise to exposure to these risks, notifications received from policyholders, the nature and extent of the cover provided, the current legal environment, changes in the effectiveness of clean up techniques and industry benchmarks of the typical cost of claims of this kind and of total expected insured losses. Further details on the inherent uncertainties in these claims provisions are provided in Note 35.

(f) Reinsurance

Contracts entered into by the Group with reinsurers, under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts. Contracts that do not meet these classification requirements are classified as financial instruments. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts, provided there is significant transfer of insurance risk.

The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of such recoveries, adjusted to reflect changes in the nature and extent of the company's reinsurance programme over time. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the profit and loss account as 'Outward reinsurance premiums' when due.

ABI, 94-96

Claims provisions should be sufficient at all times to cover liabilities arising out of insurance contracts that can reasonably be foreseen, and should be set such that no adverse run-off deviation is envisaged. Insurance undertakings should take all reasonable steps to ensure they have appropriate information regarding their claims exposures, and the level of provision should be assessed having regard to the range of uncertainty as to the eventual outcome. Where the uncertainty is considerable, a degree of caution will be necessary in the exercise of judgement for setting provisions. As noted above, where there is inherent uncertainty in estimating technical provisions, appropriate disclosure should be made.

ABI, 240

ABI, 98

The deduction of salvage and subrogation recoveries from outstanding claims is only permissible where these amounts are immaterial. Where material, such recoveries should be included in "other debtors".

ABI, 249-250

In accordance with FRS 5, the economic substance of all reinsurance contracts must be reflected in the result for the year and the balance sheet. A key characteristic of reinsurance is the transfer and assumption of reinsurance risk and so reassurance contracts that do not transfer significant risk should not be accounted for as contracts of reinsurance.

PwC

When considering the accounting treatment of reinsurance contracts ceded that transfer all the risks of the underlying contracts, it is appropriate to have regard to the FRS 26 classification of the underlying contracts accepted in order to achieve accounting symmetry.

ABI, 255

Where a reinsurance contract contains identifiable elements that do not result in the transfer of insurance risk, these should be separately accounted for.

ABI, 257

In determining whether assets and liabilities should be recognised, the following three stage process is to be followed:

- consideration of the transaction in conjunction with any other where this is necessary to obtain an understanding of the overall commercial effect;
- determination of the reasonably possible outcomes of the transaction having regard to its commercial effect, uncertainty, and the intentions of the parties to the transaction insofar as these assist in determining its substance; and
- assessment of whether assets and/or liabilities have been created based on the above stages.

ABI, 260

Assets created by reinsurance contracts should normally be valued on the same basis as the related reinsured liabilities, subject to any allowance for bad debt.

ABI, 34

Where a reinsurance contract is intended, in whole or in part, to mitigate the requirement to establish prudent provisions, and/or to provide an element of financing, the identifiable elements of the contract which do not transfer significant insurance risk are considered to be financial reinsurance.

ABI, 261

Where material, any financial reassurance element should not result in a net credit to the profit and loss account on inception of the contract, even where the main purpose of a reassurance contract is the transfer of insurance risk.

ABI, 262

Disclosure of reassurance contracts should enable a full understanding of their effect on the results in the financial statements.

**Investment contracts**

ABI, 162

Amounts collected in respect of certain group healthcare contracts, which principally involve the transfer of financial risk, are accounted for using deposit accounting, under which amounts collected are credited directly to the balance sheet as an adjustment to the liability to the policyholder. Investment contract liabilities are carried in the balance sheet at amortised cost and shown as 'Other technical provisions'. Fees receivable from investment contracts (included in 'Other technical income') and investment income and interest payable on contract balances are recognised in the profit and loss account in the year they are assessed unless they relate to services to be provided in future years, in which case they are deferred and recognised as the service is provided.

Commissions incurred in respect of these contracts are deferred in line with the recognition of fee income and included in the balance sheet within deferred acquisition costs.

ABI, 161

Incremental costs that are directly attributable to securing an investment contract (such as the Group healthcare contracts recognised by Proforma-Gen Limited as investment contracts under FRS 26) are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. An incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

## D Discounted claims provisions

Sch3, 54

On third-party liability business, due to the long delay between the inception date of the policy and the final settlement of the claim, the outstanding claims provisions are discounted to take account of the expected investment income receivable between inception and settlement on the assets held to cover the provisions.

**Discounting**

ABI, 105-108

Schedule 3 and the ABI SORP set out the accounting principles and disclosure requirements where claims liabilities are discounted to take account of future investment income. Discounting is permitted on an explicit basis for categories of claims where the expected mean period between the accounts date and the settlement of gross claims is at least four years. Discounting should only be considered where data exist to model the claims settlement pattern reliably.

ABI, 109

The discount rate should not exceed a rate expected to be earned on the assets backing the liabilities and also should not exceed either a rate justified by the performance of such assets over the preceding five years or a rate justified by the performance of such assets during the year preceding the balance sheet date.

ABI, 110

Justification involves consideration of historical returns to the extent this is relevant to the future.

## E Unexpired risks provision

ABI, 124
ABI, 117

Provision has been made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date.

ABI, 118

Unexpired risks surpluses and deficits are offset where business classes are managed together and a provision is made if an aggregate deficit arises. The unexpired risks provision is included within 'Other technical provisions'.

**Offset of surpluses and deficits**

ABI, 118

Offset of surpluses and deficits is permitted where business classes are "managed together".

ABI, 119

To qualify as managed together, business classes must either be written together as separate parts of the same insurance contracts or have significant common characteristics which are relevant to the assessment of risk and setting of premiums. In addition there must be no constraint on the use of assets held in relation to such business to meet any of the associated liabilities.

**Future investment return**

ABI, 122

The investment return to be taken into account is that anticipated to be earned by the investments supporting the unearned premiums and unexpired risks provision from the balance sheet date until the settlement of the claims.

**Post balance sheet claims events**

ABI, 121, 124

The ABI SORP states that post balance sheet claims events that were not capable of prediction at the balance sheet date should not be taken into account in determining the requirement for an unexpired risks provision. However, exceptional claims events occurring between the balance sheet date and the date on which the financial statements are approved by the board should be disclosed, with an estimate of their financial effect.

## F Equalisation provision

ABI, 125

Amounts are set aside as equalisation provisions in accordance with the PRA's Handbook for the purpose of mitigating exceptionally high loss ratios in future years. The amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date. Notwithstanding this, they are required by Schedule 3 to SI2008/410 to be included within technical provisions.

## G Financial liabilities

FRS 26, 43, 47

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost, any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognised in the profit and loss account as interest expense.

Other financial liabilities relate to investment contract liabilities under certain group healthcare contracts where there is no transfer of significant insurance risk. These liabilities are carried at amortised cost and are included within 'Other technical provisions' (see accounting policy C above 'Basis of accounting - Investment contracts'.)

Creditors are also financial liabilities and are recognised initially at fair value, net of directly attributable transaction costs. Creditors are subsequently stated at amortised cost, using the effective interest method.

**FRS 26 Measurement of financial liabilities**

See Accounting policy I 'Investments' below for discussion of the provisions of FRS 26 relating to recognition and derecognition and to the initial measurement of financial instruments (including financial liabilities).

***Subsequent measurement***

After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:

FRS 26, 47

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost;
(b) financial liabilities that arise when a transfer of an asset does not qualify for derecognition;
(c) financial guarantee contracts; and
(d) commitments to provide loan at below market interest rates.

**Undated subordinated loan notes**

PwC

In order to raise capital loan notes for regulatory return purposes, many insurance groups have issued subordinated loan notes. In some instances, the coupon payable on such debt can be deferred which may result in them being treated as equity rather than debt under the presentation requirement of FRS 25. It is therefore necessary to consider carefully the detailed terms of any undated subordinated loan notes to ensure that the classification of such instruments under FRS 25 is appropriate.

Proforma-Gen Limited has not issued any undated subordinated loan notes.

## H Goodwill

FRS 10, 55

Sch3, 42

Goodwill is capitalised in the balance sheet at cost and amortised through the profit and loss account over its useful economic life on a straight-line basis. Goodwill is tested annually for impairment. The gain or loss on any subsequent disposal of subsidiary or associated undertakings will include any attributable unamortised goodwill.

FRS 10, 71(a)

Prior to 1998, goodwill was eliminated against reserves as a matter of accounting policy. As permitted under the transitional arrangements of FRS 10 such amounts previously written off to reserves have not been reinstated as an asset, but will be charged to the profit and loss account on any disposal of the business to which they relate.

FRS 10, 7&8

FRS 10 'Goodwill and intangible assets' requires purchased goodwill to be capitalised as an asset In the balance sheets and systematically amortised over its useful economic life. Internally generated goodwill should not be capitalised.

FRS 10, 15
FRS 10, 55
FRS 10, 58 & 59

Where goodwill is regarded as being of limited economic life it should be amortised over that life. The method and periods of amortisation adopted should be disclosed. There is a rebuttable presumption that purchased goodwill has a finite useful economic life of less than 20 years. Additional disclosures are required if goodwill is either not amortised, or amortised over a period of more than 20 years.

FRS 10, 34

The carrying value of goodwill being amortised over a period of 20 years or less needs to be reviewed for impairment at the end of the first full financial year following the initial recognition of the goodwill and subsequently only when events or changes in circumstances indicate the goodwill may not be recoverable in full.

FRS 10, 65

Transitional provisions allowed goodwill previously written off against reserves not to be reinstated on the first application of FRS 10. This option could have been exercised in respect of:

FRS 10, 69

- goodwill relating to acquisitions prior to 23 December 1998 (where information is not readily available); or
- goodwill eliminated prior to implementation of FRS 7; or
- all goodwill previously eliminated.

FRS 10, 71

Where the transitional provisions have been utilised, disclosure is required of the policy adopted, the amount of goodwill remaining eliminated against reserves and the fact that this will be charged to the profit and loss account on a subsequent disposal. On first application of FRS 10, Proforma-Gen Limited adopted the transitional provisions in respect of all goodwill previously eliminated.

UITF 27, 5

Where estimates of the useful economic lives of goodwill or intangible assets are revised, the carrying value should be amortised over the revised remaining useful economic life. This requirement applies equally where the presumption of a 20-year life has previously been rebutted as it does to other revisions of estimates of the useful economic lives of goodwill and intangible assets.

## I Investments

### Land and buildings

Sch3, 22(1), 26, 28(2)

Land and buildings are valued at open market valuation. Full valuations are made by independent, professionally qualified valuers every three years. In the intervening years these valuations are updated by the directors with the assistance of independent professional advice as required. The aggregate surplus or deficit on revaluation is taken to the non-technical account.

Sch3, 37
SSAP 19
FRS 18, 62

In accordance with SSAP 19, no depreciation or amortisation is provided in respect of freehold investment properties and leasehold investment properties with over 20 years to run. The requirement of the Companies Act 2006 is to depreciate all properties. This requirement conflicts with the generally accepted accounting principle set out in SSAP 19. The directors consider that, as these properties are held for investment, to depreciate them would not give a true and fair view, and that it is necessary to adopt SSAP 19 in order to give a true and fair view. Depreciation is only one of the factors reflected in the annual valuations, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified.

ABI, 267

Owner-occupied properties do not satisfy the definition of investment properties and so are not exempt from the requirement that they are depreciated. In the accounts of Proforma-Gen Limited, such depreciation would be immaterial.

### Investments in Group undertakings and participating interests

In the balance sheet of the Company, investments in Group undertakings and participating interests are stated at cost, unless their value has been impaired in which case they are valued at their realisable value or value in use as appropriate. Participating interests are included in the consolidated balance sheet at the Group's share of their net assets.

ABI, 269, 34, 273

In single entity insurance company accounts, shares in group undertakings and participating interests are required to be stated at current value, determined in accordance with paragraph 25 of Schedule 3 to SI2008/410.

ABI, 278

Movements in the value of investments in group undertakings and participating interests shown in the balance sheet at current value should be taken to the revaluation reserve.

Sch1, 32

Proforma-Gen Limited is a non-insurance holding company preparing entity accounts in accordance with Schedule 1. Under Schedule 1 investments may be included at historical cost, market value or any basis which appears to the directors to be appropriate.

FRS 26 does not apply to those interests in subsidiary, quasi-subsidiary and associated undertakings, partnerships and joint ventures that are accounted for under FRS 2 'Accounting for subsidiary undertakings'; FRS 5 'Reporting the substance of transactions'; and FRS 9 'Associates and joint ventures', unless held for resale. FRS 26 will however apply to derivatives on an interest in a subsidiary, quasi-subsidiary or associated undertaking, partnership or joint venture unless the derivative meets the definition of an equity instrument of the entity under FRS 25.

**FRS 26 'Financial Instruments: Recognition and Measurement' and FRS 29 'Financial Instruments: Disclosures'**

FRS 25 and FRS 26 implement IAS 32 and IAS 39 respectively into UK GAAP. FRS 26 sets out the requirements for the recognition and measurement of financial instruments whereas FRS 25 addresses the presentation requirements. The application of FRS 26 is mandatory for listed entities and unlisted entities applying the fair value accounting rules make under the Companies Act or marking to market any financial instrument that (in the case of insurers) is not explicitly permitted by Schedule 3. In practice any unlisted insurer that holds any derivatives at fair value is within the scope of FRS 26 (and also FRSs 23, 24, and 29).

FRS 29, 43, 44

Disclosure provisions in respect of financial instruments are set out in FRS 29 'Financial Instruments: Disclosures' (which implements IFRS 7 into UK GAAP).

***Recognition and derecognition***

FRS 26 incorporates the provisions of IAS 39 relating to recognition and derecognition of financial instruments. FRS 5 and the ABI SORP continue to apply to the recognition and derecognition of non-financial assets and liabilities.

FRS 26, 14

An entity only recognises a financial asset or liability at the time it becomes a party to the instrument's contractual provisions i.e. at the time it has the contractual rights or obligations.

PwC

Recognition issues for financial assets and liabilities tend to be straightforward whereas derecognition issues, particularly in relation to financial assets, can be complex. Many financial instruments comprise components – bundles of contractual rights and/or contractual obligations that are financial assets and financial liabilities in their own right. Transactions may occur that leave in place certain of the components that give rights to future benefits, while transferring the other components to one or more parties. Securitisation transactions, loan transfers and transfers involving derivatives, debt factoring, repurchase agreements and stock lending agreements are examples of such complex transactions.

FRS 26, 38

A 'regular way' purchase of securities may be recognised using either trade date or settlement date accounting, providing the method is applied consistently within each of the four categories of financial assets.

FRS 26, 9

FRS 26 defines a regular way purchase (or sale) of securities as a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.

FRS 26, 15-23

Derecognition of a financial asset occurs only when the seller has transferred the asset's risks and rewards (either substantially or partially) or control of the contractual rights have been transferred from the seller to the buyer. The evaluation of the transfer of risks and rewards should precede an evaluation of the transfer of control for all types of transaction. The positions of both the buyer and the seller should be considered but the seller's position is seen as more relevant. An entity may achieve partial derecognition whereby it recognises the components that have been retained, or new assets or liabilities such as those that arise from issuing a guarantee.

FRS 26, 20(c)

If the entity determines that it has neither retained nor transferred substantially all of an asset's risks and rewards and that it has retained control, the entity should continue to recognise the asset to the extent of its continuing involvement.

PwC

Even though legal transfer may have occurred, this does not necessarily lead to the derecognition of a financial asset if risks and rewards of the asset are retained.

FRS 26, AG36

FRS 26 acknowledges the complexity of the derecognition provisions in relation to financial assets and introduces a step-by-step approach to analysing transactions that sets out when and in what order the various approaches are to be applied. A flowchart is provided to assist in evaluating whether and to what extent a financial asset is derecognised.

FRS 26, 26

On derecognition, the difference between the amount received and the asset's carrying amount is recognised in profit or loss. Any fair value adjustment to the asset formerly reported in equity is recycled to profit or loss.

FRS 26, 39

The derecognition rules for financial liabilities focus solely on the legal release of the contractual obligations.

FRS 26, 41

On derecognition, the difference between the consideration paid and the liability's carrying amount is recognised in profit or loss.

***Initial measurement***

FRS 26, 43

When a financial asset (or liability) is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset (or liability) not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

FRS 26, AG64
FRS 29, 28

The best evidence of fair value at initial recognition is the transaction price (i.e. the fair value of the consideration given or received). However, for financial instruments for which there is no active market there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:

(a) its accounting policy for recognising that difference in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price; and
(b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference.

FRS 26, AG64

If part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique. For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

***Subsequent measurement***

FRS 26, 46

After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:

(a) loans and receivables shall be measured at amortised cost using the effective interest method;
(b) held-to-maturity investments shall be measured at amortised cost using the effective interest method; and
(c) investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, shall be measured at cost.

All financial assets except those measured at fair value through profit or loss are subject to review for impairment.

***Fair value option***

FRS 26, 9
FRS 26, 55

Under FRS 26 financial assets that are measured at fair value are either accounted for at fair value through profit and loss (where all gains and losses are taken to the profit and loss account) or as available for sale (AFS) where unrealised gains and losses (other than impairment losses) are initially recorded in the statement of total recognised gains and losses.

FRS 26, 9

Financial assets that are held for trading (including all derivatives) are required to be accounted for at fair value through profit and loss.

FRS 26, 9(b)

Other financial assets measured at fair value will be accounted for as AFS unless they are designated as at fair value through profit and loss. A financial asset may be so designated where doing so results in more relevant information, because either:

- it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch' (that would otherwise arise from measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel, for example the entity's board of directors and chief executive officer.

***Amortised cost***

FRS 26, 9

The amortised cost is the amount at which the financial asset, or financial liability, is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

***Effective interest method***

FRS 26, 9

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. In those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

FRS 26, AG6

When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate.

FRS 26, AG7

For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect movements in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

FRS 26, AG8

If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustment is recognised as income or expense in profit or loss.

FRS 26, 50B, 50D

***Reclassification of certain financial assets***

Reclassifications of financial assets classified as held for trading (but not designated under the fair value option), are permitted:

- if the financial asset meets the definition of a loan or receivable at the date of reclassification and the entity now has the intent and ability to hold it for the foreseeable future or to maturity; and
- for other financial assets (that is, those that do not meet the definition of a loan or receivable at the date of reclassification), only in rare circumstances.

FRS 26, 50E

Assets classified as available-for-sale (AFS) may be reclassified as loans and receivables provided:

- they would have met the definition of a loan or receivable, and
- the company has the intent and ability to hold the asset for the foreseeable future or to maturity.

FRS26, 103G

Any reclassification made on or after 1 November 2008 takes effect from the date of reclassification.

FRS26, 50F

At the date of reclassification the fair value of any financial asset reclassified under these provisions becomes its new cost or amortised cost as applicable. The entity will spread over the life of the asset the effect of any subsequent increase in the estimated cash receipts of a reclassified asset as a result of increased recoverability of those cash receipts by adjusting the effective interest rate prospectively, rather than recognising the impact of the increasing cash receipts immediately in the profit or loss account under the cumulative catch-up approach in FRS 26.

Proforma-Gen has not reclassified any financial assets.

FRS 29, 12

If an entity reclassifies a financial asset between 'at fair value' and 'at cost or amortised cost', the amounts reclassified and the reason for the reclassification should be disclosed.

***Fair value measurement considerations***

In determining the fair value of a financial asset (or liability) for the purposes of FRS 26 the following applies:

***(i) Active market: quoted price***

FRS 26, AG 71-72

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction, the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate.

***(ii) No active market: valuation technique***

FRS 26, AG74

If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available; reference to the current fair value of another instrument that is substantially the same; discounted cash flow analysis; and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.

***(iii) No active market: equity instruments***

FRS 26, AG80

FRS 26, AG81

The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If a reasonable assessment cannot be made then the instrument cannot be carried at fair value.

***Disclosure of accounting policies***

An insurer is required to include the following within its accounting policy for financial instruments:

- basis of recognition and measurement of financial assets (cost or valuation);

FRS 26, 45
- basis of classification of financial assets between classes;

FRS 29, 43-44
- methods and, where a valuation technique is used, assumptions applied in determining fair values for each class of financial assets or financial liabilities;

FRS 26, 58
- recognition and measurement of impairment of financial assets;

FRS 29, App B5(a)
- for financial assets designated as at fair value through profit or loss:
  - (i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;
  - (ii) the criteria for so designating such financial assets or financial liabilities on initial recognition; and
  - (iii) how the entity has satisfied the FRS 26 conditions for such designation. Narrative descriptions may be required to explain either (i) the circumstances underlying the measurement or recognition inconsistency that would otherwise arise if this designation was not used; or (ii) how this designation is consistent with the entity's documented risk management or investment strategy;

FRS 29, App B5 (b)
- the criteria for designating financial assets as available for sale;

FRS 29, App B5 (d)
- when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
  - (i) the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and
  - (ii) the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets.

FRS 29, App B5 (e)
- how net gains or net losses on each category of financial instruments are determined;

FRS 29, App B5 (f)
- the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred;

FRS 29, App B5 (g)
- when the terms of financial assets that would otherwise be past due or impaired have been re-negotiated, the accounting policy for financial assets that is the subject of re-negotiated terms.

FRS 29, 4

FRS 29 applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of FRS 26. Unrecognised financial instruments include some financial instruments that, although outside the scope of FRS 26, are within the scope of FRS 29 (such as some loan commitments).

FRS 29, 6, B2, B3

Certain disclosures are required by class of financial instrument, which are determined by the entity and are, thus, distinct from the categories of financial instruments specified in FRS 26. Financial instruments should be grouped into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. Sufficient information should be provided to permit reconciliation to the line items presented in the balance sheet. As a minimum an entity shall distinguish between instruments measured at amortised cost from those measured at fair value and treat any financial instruments outside the scope of FRS 26 as a separate class. The objective of this exercise is to combine information so as to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between excessive detail and obscuring important information.

FRS 29, 12A

FRS 29 requires extensive ongoing disclosures in respect of any assets reclassified under FRS 26. In particular, an entity is required to disclose details of carrying amounts and fair values for all financial assets that have been reclassified until they are derecognised, together with details of the fair value gain or loss that would have been recognised in the income statement or equity if the financial asset had not been reclassified.

FRS 29, 2D

Subsidiary undertakings, other than banks or insurance companies, 90% or more of whose voting rights are controlled within the group, are exempt from FRS 29 provided the entity is included in publicly available consolidated financial statements which include FRS 29 disclosures. This exemption also includes parent companies in respect of their single-entity financial statements. As a result in the consolidated financial statements, FRS 29 disclosures are only required at the group level.

**Other financial investments**

FRS 26, 9

The Group classifies its financial assets into the following categories: Shares and other variable-yield securities and units in unit trusts – at fair value through profit or loss; Debt securities and other fixed-income securities - held to maturity; and Deposits with credit institutions - loans and receivables. Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date.

***(a) Shares and other variable-yield securities and units in unit trusts – at fair value through profit or loss***

A financial asset is classified into this category at inception if they are acquired principally for the purpose of selling in the short term, if they form part of a portfolio of financial assets in which there is evidence of short-term profit-taking, or if so designated by management to minimise any measurement or recognition inconsistency with the associated liabilities.

Financial assets designated as at fair value through profit and loss at inception are those that are managed and whose performance is evaluated on a fair value basis. Information about these financial assets is provided internally on a fair value basis to the Group entity's key management personnel. The Group's investment strategy is to invest in listed and unlisted equity securities and fixed interest rate debt securities, and derivatives designated upon initial recognition at fair value through profit or loss.

FRS 26, AG70
Sch3, 25

The fair values of financial instruments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Sch3, 73(4)

The fair values of financial instruments that are not traded in an active market (for example, unlisted equities and over-the-counter derivatives) , are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants. The specific valuation techniques used are described in Note 1(e).

Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the profit and loss account within 'Unrealised gains on investments' or 'Unrealised losses on investments' in the period in which they arise.

***(b) Debt securities and other fixed-income securities - held to maturity***

FRS 26, 9

Redeemable fixed interest securities, in respect of which there is a positive intention to hold to maturity, are valued at amortised cost. The amortisation is calculated so as to write off the difference between the purchase price and the maturity value over the life of the security, using the effective interest method.

**Alternative valuation of fixed income securities**

Sch3, 24

Schedule 3 provides the option that debt and other fixed income securities may be included in the balance sheet at amortised cost rather than current value.

FRS 26, 9
ABI, 279

Under FRS 26 the 'Held-to-maturity' heading for investments are non-derivative financial assets with fixed and determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. This is a stricter requirement than that which applies to insurers not adopting FRS 26 who can use amortised cost for redeemable fixed interest securities for any part of a portfolio intended to be held on an ongoing basis.

FRS 26, 9

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

(a) are so close to maturity or the financial asset's call date (for example, less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;

(b) occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or

(c) are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

For illustrative purposes, Proforma-Gen Limited has met the necessary requirements of FRS 26 to enable Debt securities and other fixed-income securities to be classified as "held-to-maturity".

***(c) Deposits with credit institutions - Loans and receivables***

FRS 26, 9

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Group intends to sell in the short term or that it has designated as at fair value through profit or loss. When a financial liability is recognised initially it is measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial liability. Loans and receivables are subsequently measured at amortised cost using the effective interest method. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. This basis of valuation is viewed by the directors as having prudent regard to the likely realisable value.

Sch3, 25(5)

Sch3, 24(1)
Sch3, 25(5)

The Schedule 3 rules in respect of investments at amortised cost only apply to debt securities and other fixed-income securities. To the extent that a company values other loans and receivables at amortised cost under the provisions of FRS 26 then such a basis will need to represent "a basis which has prudent regard to the likely realisable value" in accordance with the current value accounting rules.

## J Impairment of financial assets

FRS 26, 58, 61

For financial assets not at fair value through profit or loss, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

FRS 26, 59

(a) significant financial difficulty of the issuer or debtor;
(b) a breach of contract, such as a default or delinquency in payments;
(c) it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
(d) the disappearance of an active market for that financial asset because of financial difficulties; or
(e) observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
    - adverse changes in the payment status of issuers or debtors in the group; or
    - national or local economic conditions that correlate with defaults on the assets in the group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred on loans and receivables or held-to-maturity investments carried at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the profit and loss account for the period. If a held-to-maturity investment or a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Group's grading process that considers asset type, industry, geographical location, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed through the profit and loss account for the period.

**Impairment of financial assets**

FRS 26, 63

***(i) Financial assets at amortised cost***

FRS 26 permits an entity to account for impairment losses on financial assets held at amortised cost by either reducing the carrying amount of the asset directly or through the use of an allowance account.

FRS 26, 66

***(ii) Financial assets carried at cost***

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is

linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses shall not be reversed.

FRS 29, 20(e)

The amount of any impairment loss for each class of financial asset should be disclosed. Proforma-Gen Limited has no impairment losses.

FRS 29, 16

Where an allowance account is used to record individual impairments, a reconciliation of the changes in that account during the period for each class of financial assets should be disclosed.

***(iii) Available for sale financial assets***

FRS 29, 67
FRS 29, 69

Where there is objective evidence of impairment of available for sale financial (AFS) assets the cumulative loss that had been recognised directly in equity is removed from equity and charged to profit and loss. The impairment loss is calculated as the difference between the acquisition cost (net of any principal repayment and amortisation) and current fair value (less previously recognised impairment).

FRS 29, 61

For AFS equities a significant or prolonged decline in fair value below cost is objective evidence of impairment.

FRS 29, 69
FRS 29, 70

Impairment losses on AFS equities cannot be reversed through income. Impairment losses on AFS debt securities can be reversed if, in a subsequent period, the fair value of the instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

Proforma-Gen Limited has no available for sale financial assets.

## K Investment return

Investment return comprises all investment income (which includes the interest income for financial assets carried at amortised cost, using the effective interest method), realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest payable on financial liabilities carried at amortised cost, using the effective interest method.

ABI, 310

Dividends are recorded on the date on which the shares are quoted ex-dividend and include the imputed tax credits. Interest, rents and expenses are accounted for on an accruals basis.

FRS 29, 21B

Realised gains and losses on investments carried at fair value through profit and loss are calculated as the difference between net sales proceeds and purchase price. In the case of investments included at amortised cost, realised gains and losses are calculated as the difference between sale proceeds and their latest carrying value. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and their purchase price or their fair value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

FRS 29, 21B

An entity is required to disclose the basis for reporting realised and unrealised gains and losses, interest and other items of income and expense associated with financial assets and financial liabilities.

**Calculation of realised investment gains**

FRS 3, 31A

Insurance companies are exempt from the general requirement of FRS 3 to measure "realised gains" by reference to the net carrying amount.

ABI, 294
Sch3 PL (10)

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the technical account of the longer-term investment return (as estimated by the directors) on

investments supporting the insurance technical provisions and related shareholders' funds. This transfer is made so that the balance on the technical account is based on a longer-term rate of investment return and is not subject to distortion from short-term fluctuations in investment return.

**ABI, 291**

The ABI SORP permits, but does not require, a form of presentation which enables the reader to identify operating results based on the longer term rate of investment return. This return may be recorded within the general business and long term business technical accounts and may also be disclosed separately as part of the total operating profit. For general insurers, this can be achieved by allocating the element of investment return reflecting the longer-term investment return on investments supporting the general insurance technical provisions and all the relevant shareholders' funds from the non-technical account to the technical account. The technical account will then include the longer-term investment return relating to the investments attributable to the general insurance business. This is the treatment adopted in Proforma-Gen Limited's accounts.

**ABI, 296**

**PwC**

No guidance is given as to what comprises "related" shareholders' funds. We interpret this to refer to the element of shareholders' funds supporting the carrying out of general insurance. Investment return relating to any surplus shareholders' funds or to shareholders' funds supporting other activities of the group should remain in the non-technical account.

In these accounts it has been assumed that all investment return supports the general insurance technical provisions and related shareholders' funds. As a result, the net investment return included in the non-technical accounts relates solely to short-term fluctuations in investment return.

**ABI, 291**

Alternatively, disclosure of technical results reflecting the longer-term rate of return may be made as a memorandum item on the face of the profit and loss account without making any allocation of investment return.

**ABI, 292**

If the longer-term rate is not used, an allocation of actual investment return from investments supporting the general insurance technical provisions and associated shareholders' funds, from the non-technical account to the technical account, may be made.

**ABI, 292**

The allocation may not be made on any other basis.

**ABI, 48**

The longer-term rate of investment return is an estimate of the long-term trend investment return having regard to past performance, current trends and future expectations.

**ABI, 305**

In respect of equities and properties the directors have estimated the longer-term rates of investment return to be as follows:

**Longer-term rates of investment return**

| | 2013 | 2012 |
|---|---|---|
| Equities – Sterling | **7.9%** | 8.4% |
| – US$ | **6.1%** | 6.2% |
| Properties | **5.7%** | 5.7% |

**ABI, 303**

The longer-term rate of investment return for fixed interest securities of 5.4% (2012: 5.6%) is calculated on the amortised cost basis with realised gains and losses subject to continuing amortisation over the remaining period to the maturity date.

**ABI, 300**
**ABI, 301**
**ABI, 302**

Longer-term rates of investment return for equities and properties must be calculated separately. The calculations should use best estimates based on historical rates experienced and current inflation expectations. Consideration should be given to the business' actual returns over a period of not less than five years, to longer-term rates of return used by the business for other purposes (e.g. product pricing) and to external expectations and influences. The rates thus determined should be reviewed at least annually although changes would be expected only infrequently.

PwC — In practice, the setting of the longer-term rate of return is a subjective area, particularly in determining how much weight to give to historical performance and how much to current expectations.

PwC — Judgement will also need to be exercised in assessing when deviations of actual investment return from the assumed longer-term rate indicate that the longer-term rate requires adjustment.

ABI, 303 — The longer-term rate of return in respect of redeemable fixed interest securities may be determined either by using a redemption yield or on the amortised cost basis. In the case of irredeemable fixed interest securities and short-term assets, the longer-term investment return should be the interest income receivable in respect of the financial year.

ABI, 299 — The allocation of investment return is calculated by applying the longer-term rate of investment return for each investment category to the quarterly weighted average of the corresponding assets. The allocation is adjusted to exclude the effect of any short-term market movements.

ABI, 299 — The alternative method set out in the ABI SORP of calculating the transfer of investment return for equities and properties is to gross up actual investment income by a factor representing the longer-term rate of investment return divided by an assumed longer-term dividend or rental yield (making adjustments for any special factors which have distorted the underlying yield of the portfolio).

If this method is adopted, the assumed long-term rates of dividend yield or rental yield should be disclosed.

## L Derivative financial instruments

FRS 26, 43, 46 — Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value are recognised immediately in the profit and loss account. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

FRS 26, AG64 — The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

When unobservable market data has an impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation model is not recognised immediately in the profit and loss account but over the life of the transaction on an appropriate basis, or when the inputs become observable, or when the derivative matures or is closed out.

FRS 26, 10, 11 — Embedded derivatives that are not closely related to their host contracts and meet the definition of a derivative are separated and fair valued through the profit and loss account.

**FRS 26 (IAS 39) 'Financial instruments: Recognition and Measurement'**
**Hedging**

FRS 26, 71 — If there is a designated hedging relationship between a hedging instrument (which in most circumstances will be a derivative) and a hedged item, accounting for the gain or loss on the hedging instrument and the hedged item will follow the treatments set out in FRS 26.

FRS 26, 86 — Hedging relationships are of three types;

- FRS 26, 29 — fair value hedges (where the gain or loss on the hedging instrument and gains or losses on the hedged item arising from the hedged risk are recognised in profit or loss);
- FRS 26, 95 — cash flow hedges (where the gain or loss on the effective portion of the hedging instrument is taken through the statement of total recognised gains and losses until the hedged transaction affects the profit and loss account); or

FRS 26, 102

- hedges of a net investment in a foreign operation (where the gain or loss on the effective portion of the hedging instrument is taken through the statement of total recognised gains and losses to match the gain or loss on net assets).

***Qualifying hedges***

FRS 26, 73

For hedge accounting purposes, only instruments that involve a party external to the reporting entity (i.e. external to the group, segment or individual entity that is being reported on) can be designated as hedging instruments. Although individual entities within a consolidated group or divisions within an entity may enter into hedging transactions with other entities within the group or divisions within the entity, any such intragroup transactions are eliminated on consolidation. Therefore, such hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the group. However, they may qualify for hedge accounting in the individual or separate financial statements of individual entities within the group or in segment reporting provided that they are external to the individual entity or segment that is being reported on.

FRS 26, 88

A hedge relationship qualifies for hedge accounting if, and only if, all of the following conditions are met;

- at the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk;
- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;
- for cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss;
- the effectiveness of the hedge can be reliably measured; and
- the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

***Disclosure of hedging transactions***

FRS 29, 22

For each type of hedging relationship the following should be disclosed:

(a) a description of each type of hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and

(c) the nature of the risks being hedged.

FRS 29, 23

The following additional disclosures are required for cash flow hedges:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

(c) the amount that was recognised in equity during the period;

(d) the amount that was removed from equity and included in profit or loss for the period, showing the amount included in each line item in the income statement; and

(e) the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.

FRS 29, 24

The impact of hedging transactions on profit or loss are required as follows:

(a) in fair value hedges, gains or losses:

(i) on the hedging instrument; and

(ii) on the hedged item attributable to the hedged risk.

(b) the ineffectiveness recognised in profit or loss that arises from cash flow hedges; and

(c) the ineffectiveness recognised in profit or loss that arises from hedges of net investments in foreign operations.

Proforma-Gen Limited has no designated hedging relationships.

**Embedded derivatives**

FRS 26, 10

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract.

FRS 26, 11

An embedded derivative shall be separated from the host contract and accounted for as a derivative under FRS 26 if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).

FRS 26, 2(e)

The above requirements apply to derivatives embedded in an insurance contract unless the embedded derivative is itself an insurance contract.

FRS 26, 11

If an embedded derivative is separated, the host contract shall be accounted for under FRS 26 if it is a financial instrument and in accordance with other appropriate Standards if it is not a financial instrument.

FRS 26, 11A

Notwithstanding the above, if a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:

(a) the embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or

(b) it is clear with little or no analysis when a similar hybrid (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

FRS 26, 12

If an entity is required to separate an embedded derivative from its host contract, but is unable to measure the embedded derivative separately either at acquisition or at a subsequent financial reporting date, it shall designate the entire hybrid (combined) contract as at fair value through profit or loss.

FRS 29, 17

If an instrument contains both a liability and an equity component under FRS 25 and the instrument has multiple embedded derivatives whose values are interdependent, those features should be disclosed.

Proforma-Gen Limited has no embedded derivatives that require separation.

## M Tangible assets

FRS 15, 100(a) & 100(b)

Tangible assets are capitalised and depreciated by equal annual instalments over their estimated useful lives. The principal rates used for this are as follows:

| | |
|---|---|
| Motor vehicles | 25% |
| Computer equipment | 33⅓% |
| Fixtures, fittings and office equipment | 10% |

FRS 15 "Tangible fixed assets" sets out the principles of accounting for the initial measurement, valuation and depreciation of tangible fixed assets. Investment properties continue to be accounted for in accordance with SSAP19.

FRS 15, 31

Where finance costs are capitalised, the following information should be disclosed:

- accounting policy adopted;
- aggregate amount of finance costs included in the cost of tangible fixed assets;
- the amount of finance costs capitalised during the period;
- the amount of finance costs recognised in the profit and loss account during the period; and
- the capitalisation rate used to determine the amount of finance costs capitalised during the period.

FRS 11, 8

Impairment reviews should be carried out if events or changes indicate that the carrying amount of fixed assets or goodwill may not be recoverable.

FRS 11, 14

Any excess of carrying value over recoverable amount should be written down.

FRS 11, 13

It is anticipated that, for tangible fixed assets, impairments will be relatively infrequent.

The requirements for review also extend to fixed asset investments in group undertakings and participating interests in the parent company balance sheet where that is prepared in accordance with Schedule 1.

## N Deferred tax

FRS 19, 7
FRS 19, 37
FRS 19, 34

Provision is made for deferred tax liabilities, using the liability method, on all material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account. Deferred tax is calculated at the rates at which it is expected that the tax will arise. Deferred tax is recognised in the profit and loss account for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in the statement of total recognised gains and losses. Deferred tax balances are not discounted.

FRS 19, 35

Where a gain or loss has been recognised directly in the statement of total recognised gains and losses, deferred tax attributable to that gain or loss should also be recognised directly in that statement.

FRS 19, 42
FRS 19, 44

Companies are permitted, but not required, to discount deferred tax assets and liabilities to reflect the time value of money. If discounting is adopted, all deferred tax balances that have been measured by reference to undiscounted cash flows and for which the impact of discounting is material should be discounted. Proforma-Gen has elected not to discount.

FRS 17, 76(a)

## O Pension costs

The Group operates a defined benefit pension scheme. The pension asset recognised in the balance sheet is the value of the scheme's assets less the present value of the scheme's liabilities.

The pension cost for the scheme is analysed between current service cost, past service cost and net return on pension scheme. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account on a straight-line basis over the period in which the increase in benefits vest.

Net expected return on the pension asset comprises the expected return on the pension scheme assets less interest on scheme liabilities.

The actuarial gains and losses which arise from a valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date are taken to the statement of total recognised gains and losses for the period. The attributable deferred taxation is shown separately in the statement of total recognised gains and losses.

## P Foreign currencies

FRS 23
ABI, 219
Sch3, 63

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates. The UK Pounds sterling currency is the functional currency of all Group entities, with the exception of the United States branch whose functional currency is US Dollars. The consolidated financial statements are presented in millions of Pounds sterling, which is the Group's presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account for the period.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss.

The results and financial position of the United States branch are translated into the presentation currency as follows:

(a) assets and liabilities are translated at the closing rate at the balance sheet date;
(b) income and expenses are translated at the average rate of exchange during the year; and
(c) all resulting exchange differences are recognised through the STRGL as a separate component of equity.

**FRS 23 'The effects of changes in foreign exchange rates'**

Broadly speaking, FRS 23 is part of a package of standards that have to be implemented at the same time as FRS 26's application. The effective date is determined by reference to FRS 26's application.

For listed entities and unlisted entities using fair value measures FRS 23 has replaced SSAP 20. However SSAP 20 remains in place and can be used by entities not using FRS 23.

FRS 23, 8

The standard derives from IAS 21 and it sets out the requirements for initial recognition, subsequent measurement and disclosure relating to foreign currency translation. It requires each entity within the Group to determine its functional currency and measure its results in that currency. The functional currency is the currency of the primary economic environment in which the entity operates. Proforma-Gen Limited has a US branch which operates in that country, with cash being generated and expended in US Dollars and, therefore, the functional currency of the US branch is US Dollars.

FRS 23, 23

An entity may present its financial statements in any currency (the 'presentation' currency), but is required to disclose the reasons for doing so. Foreign currency transactions should be translated at the exchange rate at the date of the transaction (or an average rate, if appropriate). Foreign currency monetary assets and liabilities are retranslated at the closing (period-end) rate and exchange differences are taken to the profit and loss account. Non-monetary items denominated in a foreign currency are measured at historical rates at either the transaction date or, for items measured at fair value, the exchange rate at the date when the value was determined. Exchange differences on non-monetary items should be recognised in either equity or in the profit and loss account depending on where the underlying gain or loss on the non-monetary item is recognised.

A foreign entity's assets and liabilities (both monetary and non-monetary) are translated into a different presentation currency at the closing rate and its profit and loss account is translated at actual (average) rate with resulting exchange differences classified as a separate component of equity. On disposal of a foreign entity, the cumulative translation difference relating to the entity is included in the gain or loss on sale in the profit and loss account. FRS 23 contains specific rules requiring goodwill and fair value adjustments arising on acquiring a foreign operation to be translated at the closing rate.

PwC

The adoption of FRS 23 represented a key change for many general insurers in the way that books of foreign currency denominated business are treated. Under SSAP 20 the definition of a foreign branch includes "a group of assets and liabilities which are accounted for in foreign currencies" and under this definition many insurers had classified their foreign currency denominated books of business and backing assets as foreign branches. SSAP 20 then requires the closing rate/net investment to be used for such business under which all items in the balance sheet at the year end are translated at the closing rate of exchange and the profit and loss account is translated at the closing rate or at an average rate for the period. Under this method the results and loss ratios of the overseas book of business were not distorted by foreign exchange movements. However under FRS 23 the treatment depends on the functional currency of foreign operations. For example a US Dollar book of business written by a UK company through the London Market is likely to have UK £ as its functional currency rather than US Dollar. As a result, only monetary items (e.g. investments, outstanding claims) will be retranslated to the functional currency at the period-end rate with non-monetary items that are measured in terms of historical cost in a foreign currency (such as deferred acquisition costs and unearned premiums) using the exchange rate at the date of the transaction. Results and loss ratios of foreign currency denominated books of business may be distorted by movements in exchange rates, as a result.

FRS 23, 23(c)

## Q Operating leases

SSAP 21, 57

Rentals payable under operating leases are charged to the profit and loss account as incurred over the lease term.

## R Dividends

Tech 57/05

Interim dividends are recognised when paid and final dividends are booked as a liability when they are approved by the members passing a written resolution.

# *Notes to the financial statements for the year ended 31 December 2013*

## 1 Management of financial risk

Sch7, 6(1) (a)
FRS 29, 31
FRS 29, App A

**Financial risk management objectives**
The Group is exposed to a range of financial risks through its financial assets, financial liabilities (investment contracts and borrowings), reinsurance assets and policyholder liabilities. In particular, the key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from insurance policies and investment contracts as they fall due. The most important components of this financial risk are market risk (including interest rate risk, equity price risk and currency risk), credit risk and liquidity risk.

These risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The risks that the Group primarily faces due to the nature of its investment and liabilities are interest rate risk and equity price risk.

The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. It manages these positions within an asset liability management (ALM) framework that has been developed to achieve investment returns in excess of obligations under insurance contracts. The Group produces regular reports at portfolio, legal entity and asset and liability class level that are circulated to the Group's key management personnel. The principal technique of the Group's ALM is to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders.  Separate portfolios of assets are maintained for direct insurance business and inwards reinsurance business. The Group's ALM is also integrated with the management of the financial risks associated with the Group's other financial assets and liabilities not directly associated with insurance and investment liabilities ("Corporate"). The Group does not use hedge accounting.

The Group has not changed the processes used to manage its risks from previous periods. The notes below explain how financial risks are managed using the categories utilised in the Group's ALM framework.

The following tables reconcile the balance sheet to the categories used in the Group's ALM framework:

| 2013 | Direct business | | | | |
|---|---|---|---|---|---|
| | Insurance contracts | Investment contracts | Reinsurance business | Corporate | Total |
| | £m | £m | £m | £m | £m |
| Shares and other variable yield securities and units in unit trusts, at fair value through profit or loss: | | | | | |
| - listed securities | 521.7 | 44.4 | 274.9 | 89.7 | 930.7 |
| - unlisted securities | 109.2 | 6.3 | 53.7 | 30.0 | 199.2 |
| Derivative financial instruments, at fair value through profit or loss | 47.6 | - | 2.6 | - | 50.2 |
| Debt securities and other fixed income securities -held-to-maturity | | | | | |
| - listed securities | 441.4 | 8.6 | 274.9 | 128.1 | 853.0 |
| - unlisted securities | 60.0 | - | 24.1 | 91.6 | 175.7 |
| Loans and receivables | 303.8 | 11.2 | 42.6 | 23.7 | 381.3 |
| Deposits with ceding undertakings | 10.9 | - | - | - | 10.9 |
| Reinsurance assets | 310.5 | - | - | - | 310.5 |
| Other assets | 622.2 | 11.3 | 276.7 | 398.3 | 1,308.5 |
| **Total assets** | **2,427.3** | **81.8** | **949.5** | **761.4** | **4,220.0** |
| | | | | | |
| Provision for unearned premiums | 541.8 | - | 191.8 | - | 733.6 |
| Claims outstanding | 1,374.6 | - | 616.4 | - | 1,991.0 |
| Equalisation provision | 15.0 | - | 5.2 | - | 20.2 |
| Provision for unexpired risks | 17.8 | - | - | - | 17.8 |
| Financial liabilities under investment contracts | - | 67.4 | - | - | 67.4 |
| Provisions for other risks and charges | 29.3 | 2.4 | 15.7 | 16.1 | 63.5 |
| Deposits received from reinsurers | 5.8 | - | - | - | 5.8 |
| Borrowings | - | - | - | 178.8 | 178.8 |
| Other liabilities | 158.5 | - | 19.4 | 84.0 | 261.9 |
| **Total liabilities** | **2,142.8** | **69.8** | **848.5** | **278.9** | **3,340.0** |

| 2012 | Direct business | | | | |
|---|---|---|---|---|---|
| | Insurance contracts | Investment contracts | Reinsurance business | Corporate | Total |
| | £m | £m | £m | £m | £m |
| Shares and other variable yield securities and units in unit trusts, at fair value through profit or loss: | | | | | |
| - listed securities | 411.1 | 41.5 | 364.1 | 90.7 | 907.4 |
| - unlisted securities | 90.1 | 5.6 | 47.4 | 29.3 | 172.4 |
| Derivative financial instruments, at fair value through profit or loss | 43.4 | - | 2.3 | - | 45.7 |
| Debt securities and other fixed income securities -held-to-maturity | | | | | |
| - listed securities | 424.2 | 7.4 | 251.1 | 102.0 | 784.7 |
| - unlisted securities | 63.7 | 10.9 | 15.7 | 107.4 | 197.7 |
| Loans and receivables | 272.3 | - | 35.5 | 21.1 | 328.9 |
| Deposits with ceding undertakings | 11.8 | - | - | - | 11.8 |
| Reinsurance assets | 298.9 | - | - | - | 298.9 |
| Other assets | 536.4 | 10.7 | 249.4 | 408.9 | 1,205.4 |
| **Total assets** | **2,151.9** | **76.1** | **965.5** | **759.4** | **3,952.9** |
| | | | | | |
| Provision for unearned premiums | 472.0 | - | 213.6 | - | 685.6 |
| Claims outstanding | 1,319.4 | - | 609.2 | - | 1,928.6 |
| Equalisation provision | 7.1 | - | 3.1 | - | 10.2 |
| Provision for unexpired risks | - | - | - | - | - |
| Financial liabilities under investment contracts | - | 59.8 | - | - | 59.8 |
| Provisions for other risks and charges | 14.4 | 1.6 | 11.0 | 25.5 | 52.5 |
| Deposits received from reinsurers | 6.2 | - | - | - | 6.2 |
| Borrowings | - | - | - | 172.4 | 172.4 |
| Other liabilities | 180.0 | - | 20.3 | 31.8 | 232.1 |
| **Total liabilities** | **1,999.1** | **61.4** | **857.2** | **229.7** | **3,147.4** |

PwC

**FRS 29 'Financial instruments: Disclosures'**

FRS 29 focuses on improving the transparency of entities' financial risk profiles by restructuring and extending the current disclosure requirements in relation to financial instruments in three key areas: qualitative risk disclosures 'through the eyes of management'; comprehensive quantitative disclosures; and the introduction of sensitivity analysis to market risks.

FRS 29, 31

FRS 29 requires information to be disclosed that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date. These typically include credit risk, liquidity risk and market risk.

FRS 25, 11

It should be remembered that the definition of a financial instrument is wide and includes simple instruments such as borrowings, other creditors and debtors, and cash, as well as more complex instruments. The disclosure requirements of FRS 29 apply equally to all financial instruments.

***Qualitative disclosures***

FRS 29, 32A

Providing qualitative disclosures in the context of quantitative disclosures allows users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The interaction between qualitative and quantitative disclosures contributes to disclosure of information in a way that better enables users to evaluate an entity's exposure to risks.

For each type of risk an entity shall provide the following qualitative disclosures:

FRS 29, 33

(a) the exposures to risk and how they arise;

(b) its objectives, policies and processes for managing risk and the methods used to measure the risk; and

(c) any changes in the approach to risk management from the previous period.

***Quantitative disclosures***

FRS 29, 34

For each type of risk arising from financial instruments, an entity shall provide summary quantitative data about its exposure to that risk at the reporting date and to concentrations of risk, based on information provided internally to key management (those having authority and responsibility for planning, directing and controlling the activities of the entity directly or indirectly). If the quantitative information provided at the reporting date is not representative of the entity's exposure to risk during the period, further information should be provided.

PwC

Proforma-Gen Limited manages its exposure to risk within an ALM framework and, accordingly, the quantitative data disclosed under FRS 29 paragraph 34 reflects this basis of financial risk management. These disclosures are provided for illustrative purposes only and will not necessarily be applicable for all unlisted general insurance groups/companies. Entities will need to reflect their own individual circumstances and the specific framework in place for managing financial risk. Furthermore, it is likely that emerging best practice will develop over time.

***Sensitivity analysis***

FRS 29, 40

A sensitivity analysis is required for each component of market risk (currency, interest rate and other price risk) to which the entity is exposed at the reporting date, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date. Proforma-Gen Limited discloses three types of market risk - interest, equity price and currency risks. The methods and assumptions used in preparing the analysis and any changes from the previous period (with reasons for the changes) should be given.

FRS 29, 41

If the entity prepares a sensitivity analysis which reflects interdependencies between risk variables (e.g. interest rates and exchange rates) and uses it to manage financial risks, this may be used provided an explanation of the objectives, limitations and methods, parameters and assumptions are given.

FRS 29, B19

PwC

In preparing the required quantitative sensitivity analysis, entities should select hypothetical movements in the underlying variables that reflect a 'reasonably possible change in the relevant risk variable'. This needs to be based on the economic environment in which the insurer operates and the time frame over which it is making the assessment (usually the next annual reporting period). Recent market conditions may lead to a reassessment of what changes in variables are viewed as reasonably possible compared with the disclosures given in prior years.

***Transfers of financial assets***

FRS 29, 42A – 42H

Detailed disclosures are required, in a single note to the financial statements, where an entity either transfers the contractual rights to receive the cash flows of financial assets or retains those rights but assumes an obligation to pay those cash flows to another party. Disclosures are required both where the transferred financial assets are not derecognised and where they have been derecognised but there is a continuing involvement.

***Insurance risk***

PwC

For IFRS reporters, insurance contract disclosures under IFRS 4 are aligned with the disclosure requirements for other financial instruments. However there is no equivalent requirement in UK GAAP and hence no requirement to provide such disclosures for UK general insurers reporting under UK GAAP. Some entities may choose to provide such information on a voluntary basis.

**(a)** ***Market risk***

Sch7, 6(1)(b)

FRS 29, 33(a)(b)

- ***Interest rate risk***

Interest rate risk arises primarily from investments in fixed interest securities. In addition to the extent that claims inflation is correlated to interest rates, liabilities to policyholders are exposed to interest rate risk.

The Group monitors interest rate risk on a monthly basis by calculating the mean duration of the investment portfolio and of the liabilities to policyholders under insurance and investment contracts. The mean duration is an indicator of the sensitivity of the assets and liabilities to changes in current interest rates. The mean duration of the liabilities is determined by means of projecting expected cash flows using standard actuarial claims projection techniques. This is calculated in a consistent manner with the prior year.

Any gap between the mean duration of the assets and the estimated mean duration of the liabilities is minimised by means of buying and selling fixed interest securities of different durations.

FRS 29, 40

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date. An increase of 100 basis points in interest yields would result in additional profit for the period of £10.3m (2012: £7.5m). A decrease in 100 basis points in interest yields would result in an additional loss for the period of £10.1m (2012: £4.8m).

Sch7, 6(1) (b)

FRS 29, 33

- ***Equity price risk***

The Group is exposed to equity securities price risk as a result of its holdings in equity investments, classified as financial assets at fair value through profit or loss. Exposures to individual companies and to equity shares in aggregate are monitored in order to ensure compliance with the relevant regulatory limits for solvency purposes. Investments held are listed and traded on the UK and other recognised stock exchanges (primarily in Europe and North America).

The Group has a defined investment policy which sets limits on the Group's exposure to equities both in aggregate terms and by geography, industry and counterparty. This policy of diversification is used to manage the Group's price risk arising from its investments in equity securities.

Investment Management meetings are held monthly. At these, senior investment managers representing all Group companies meet to discuss investment return and concentration across the Group.

FRS 29, 34(a), 40

Listed equity securities represent 82% (2012: 84%) of total equity investments. If equity market indices had increased/decreased by 5%, with all other variables held constant, and all the Group's equity investments moving according to the historical correlation with the index, the profit for the year would increase/decrease by £46.5m (2012: £45.4m).

- ***Currency risk***

Sch7, 6 (1) (b)

FRS 29, 33(a) (b)

Group companies manage their foreign exchange risk against their functional currency. Foreign exchange arises when future commercial transactions or recognised assets and liabilities are denominated in a currency that is not the entity's functional currency.

The Group is primarily exposed to currency risk in respect of liabilities under policies of insurance denominated in currencies other than Sterling. The most significant currency to which the Group is exposed is the US Dollar. The Group seeks to mitigate the risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency. The Group also uses currency swaps which have the economic effect of converting certain US Dollar exposures at floating rates to fixed rates.

The Group has a US branch operation, whose net assets are exposed to foreign currency translation risk. Currency exposures are managed primarily through borrowings, although the Group has no designated hedging contracts.

FRS 29, 40

At 31 December 2013, if the pound had weakened/strengthened by 20% against the US Dollar with all other variables held constant, profit for the year would have been £1.7m (2012: £0.6m) lower/higher, mainly as a result of foreign exchange gains/losses on the translation of US Dollar denominated financial assets, carried at fair value through profit or loss and foreign exchange losses/gains on translation of US Dollar denominated borrowings.

Sch7, 6 (1) (b)

***(b) Credit risk***

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Group is exposed to credit risk are:

FRS 29, 33(a) (b)

- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance contract holders;
- amounts due from insurance intermediaries;
- amounts due from corporate bond issuers; and
- counterparty risk with respect to derivative transactions.

The Group manages the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparty, and to geographical and industry segments. Such risks are subject to regular review. Limits on the level of credit risk by category and territory are approved quarterly by the Board of Directors.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an annual basis by reviewing their financial strength prior to finalisation of any contract. In addition, management assesses the creditworthiness of all reinsurers and intermediaries by reviewing credit grades provided by rating agencies and other publicly available financial information. The recent payment history of reinsurers is also used to update the reinsurance purchasing strategy. In certain circumstances, deposits from reinsurers are also held as collateral.

Exposures to individual policyholders and groups of policyholders are collected within the ongoing monitoring of the controls associated with regulatory solvency. Where there exists significant exposure to individual policyholders, or homogenous groups of policyholders, a financial analysis equivalent to that conducted for reinsurers is carried out by the management. An analysis of policyholders and reinsurers by credit ratings produced by external rating agencies is produced periodically.

The assets bearing credit risk are summarised below, together with an analysis by credit rating:

FRS 29, 36

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Derivative financial instruments | **50.2** | 45.7 |
| Debt securities | **1028.7** | 982.4 |
| Loans and receivables | **381.3** | 328.9 |
| Assets arising from reinsurance contracts held | **521.7** | 481.0 |
| Cash at bank and in hand | **78.1** | 94.0 |
| **Total assets bearing credit risk** | **2,060.0** | 1,932.0 |
| | | |
| AAA | **1,463.2** | 1,311.8 |
| AA | **299.4** | 196.4 |
| A | **167.6** | 274.9 |
| BBB | **99.6** | 106.3 |
| Below BBB or not rated | **30.2** | 42.6 |
| **Total assets bearing credit risk** | **2,060.0** | 1,932.0 |

The concentration of credit risk is substantially unchanged compared to prior year. No credit limits were exceeded during the period. No financial assets are past due or impaired at the reporting date and management expects no significant losses from non-performance by these counterparties.

The Group maintains strict control limits on open derivative positions, by both amount and term. The amount subject to credit risk at any one time is limited to the current fair value of derivative financial assets.

FRS 29, 36

An entity shall disclose, by class of financial instrument:

- The amount that best represents its maximum exposure to credit risk at the reporting date together with a description of collateral held as security and other credit enhancements (e.g. guarantees). This disclosure is not required for financial instruments whose carrying value best represents the maximum exposure to credit risk.
- A description of collateral held as security and of other credit enhancements, and their financial effect (e.g. a quantification of the extent to which they mitigate credit risk).
- Information about the credit quality of financial assets that are neither past due nor impaired.

FRS 29, 37

Where financial assets are past due but not impaired, details of the age analysis are required. Where financial assets are impaired an analysis including factors considered in the determining that they are impaired should be given.

FRS 29, 38

Information is required of any collateral and other credit enhancements obtained during the period (where they are still held at the reporting date).

PwC

The definition of equity in FRS 25 requires that the issuer has no obligation to pay cash or transfer other assets. It follows that equity investments are subject to price risk, not credit risk. Hence, most of the FRS 29 credit risk disclosures are not relevant to investments in equity instruments. The exception is the requirement to disclose an analysis of financial assets that are impaired. This disclosure is relevant and should be given for any impaired equity investments classified as available for sale.

### (c) Liquidity risk

FRS 29, 33(a)(b), 39

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The primary liquidity risk of Proforma-Gen Limited is the obligation to pay claims to policy holders as they fall due. The projected settlement of these liabilities is modelled, on a regular basis, using actuarial techniques. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of borrowing facilities that should be in place to cover anticipated liabilities and unexpected levels of demand.

FRS 29, B10A

The table below analyses the maturity of the Group's financial liabilities, outstanding claims and financial assets. The analysis of non-derivative financial liabilities and assets is based on the remaining period at the balance sheet to the contractual maturity date.

FRS 29, 39(a), (b)

The Group's derivative instruments have been included at their fair value within the less than 6 months time bucket. This is because the contractual maturities are not essential for an understanding of the timing of the cash flows. These contracts are managed on a net-fair value basis rather than by maturity date. Net settled derivatives comprise currency swaps contracts used by the Group to manage the Group's currency profile.

FRS 29, B10A(a)

Of the £26.0m disclosed in the 2013 debenture and other loans time band 'Between 2 and 5 years' the Group intends to redeem the £10m guarantee bonds in the first quarter of 2013 (2012: nil).

The amounts disclosed in the table represent undiscounted cash flows

| | No contractual maturity date | < 6mths or on demand | Between 6mths and 1 year | Between 1year and 2years | Between 2years and 5years | > 5 years | Total | Carrying value |
|---|---|---|---|---|---|---|---|---|
| Financial liabilities and outstanding claims | £m | £m | £m | £m | £m | £m | £m | £m |
| At 31 December 2013 | | | | | | | | |
| Debenture and other loans | - | 3.0 | 3.1 | 6.6 | 26.0 | 62.3 | 101.0 | 95.0 |
| Bank loans and overdrafts | - | 32.2 | 55.6. | - | - | - | 87.8 | 83.8 |
| Financial liabilities under investment contracts | - | 44.5 | 25.9 | - | - | - | 70.4 | 67.4 |
| Deposits received from reinsurers | - | - | 5.8 | - | - | - | 5.8 | 5.8 |
| Creditors | - | 197.4 | 36.4 | - | - | - | 233.8 | 233.8 |
| Financial liabilities | **-** | **277.1** | **126.8** | **6.6** | **26.0** | **62.3** | **498.8** | **485.8** |
| Claims outstanding | - | 546.6 | 216.0 | 437.0 | 876.0 | 103.0 | 2,178.6 | 1,991.0 |
| Financial liabilities and outstanding claims | **-** | **823.7** | **342.8** | **443.6** | **902.0** | **165.3** | **2,677.4** | **2,476.8** |

FRS 29, B11E

| | No contractual maturity date | < 6mths or on demand | Between 6mths and 1 year | Between 1year and 2years | Between 2years and 5years | > 5 years | Total | Carrying value |
|---|---|---|---|---|---|---|---|---|
| Financial assets and reinsurers' share of claims outstanding | | | | | | | | |
| At 31 December 2013 | | | | | | | | |
| Shares and other variable-yield securities and units in unit trusts | 1,129.9 | - | - | - | - | - | 1,129.9 | 1,129.9 |
| Net settled derivative financial Instruments (currency swap) | - | 50.2 | - | - | - | - | 50.2 | 50.2 |
| Debt securities and other fixed-income securities | - | - | 109.0 | 447.2 | 587.8 | 526.8 | 1,670.8 | 1,028.7 |
| Deposits with credit institutions | - | 69.8 | 189.5 | 102.0 | 60.0 | 81.0 | 502.3 | 381.3 |
| Cash at bank and in hand | - | 78.1 | - | - | - | - | 78.1 | 78.1 |
| Deposits with ceding undertakings | - | 10.9 | - | - | - | - | 10.9 | 10.9 |
| Debtors | - | 838.8 | - | - | - | - | 838.8 | 838.8 |
| **Financial assets** | **1,129.9** | **1,047.8** | **298.5** | **549.2** | **647.8** | **607.8** | **4,281.0** | **3,517.9** |
| Reinsurers' share of claims outstanding | - | 37.4 | 37.4 | 68.2 | 101.8 | 34.5 | 279.3 | 267.5 |
| Financial assets and reinsurers' share of claims outstanding | **1,129.9** | **1,085.2** | **335.9** | **617.4** | **749.6** | **642.3** | **4,560.3** | **3,785.4** |

| | No contractual maturity date | < 6mths or on demand | Between 6mths and 1 year | Between 1year and 2years | Between 2years and 5years | > 5 years | Total | Carrying value |
|---|---|---|---|---|---|---|---|---|
| Financial and insurance liabilities | | £m | £m | £m | £m | £m | £m | £m |
| At 31 December 2012 | | | | | | | | |
| Debenture and other loans | - | 2.8 | 3.0 | 6.4 | 26.0 | 63.8 | 102.0 | 95 |
| Bank loans and overdrafts | - | 16.2 | 65.2 | - | - | - | 81.4 | 77.4 |
| Financial liabilities under investment contracts | - | 39.3 | 25.5 | - | - | - | 64.8 | 59.8 |
| Deposits received from reinsurers | - | - | 6.2 | - | - | - | 6.2 | 6.2 |
| Creditors | - | 175.1 | 36.3 | - | - | - | 211.4 | 211.4 |
| Financial liabilities | **-** | **233.4** | **136.2** | **6.4** | **26.0** | **63.8** | **465.8** | **449.8** |
| Claims outstanding | - | 506.7 | 209.0 | 428.0 | 870.0 | 87.6 | 2,101.3 | 1,928.6 |
| Financial liabilities and outstanding claims | **-** | **740.1** | **345.2** | **434.4** | **896.0** | **151.4** | **2,567.1** | **2,378.4** |
| **Financial assets and reinsurers' share of claims outstanding** | | | | | | | | |
| At 31 December 2012 | | | | | | | | |
| Shares and other variable-yield securities and units in unit trusts | 1,079.8 | - | - | - | - | - | 1,079.8 | 1,079.8 |
| Net settled derivative financial Instruments (currency swap) | - | 45.7 | - | - | - | - | 45.7 | 45.7 |
| Debt securities and other fixed-income securities | - | - | 133.2 | 302.3 | 556.7 | 515.5 | 1,507.7 | 982.4 |
| Deposits with credit institutions | - | 69.8 | 189.5 | 102.0 | 76.3 | 60.6 | 498.2 | 328.9 |
| Cash at bank and in hand | - | 94.0 | - | - | - | - | 94.0 | 94.0 |
| Deposits with ceding undertakings | - | 10.9 | - | - | - | - | 10.9 | 11.8 |
| Debtors | - | 838.8 | - | - | - | - | 838.8 | 776.0 |
| Financial assets | **1,079.8** | **1,059.2** | **322.7** | **404.3** | **633.0** | **576.1** | **4075.1** | **3,318.6** |
| Reinsurers' share of claims outstanding | - | 36.2 | 32.4 | 64.2 | 89.2 | 50.3 | 272.3 | 259.4 |
| Financial assets and reinsurers' share of claims outstanding | **1,079.8** | **1,095.4** | **355.1** | **468.5** | **722.2** | **626.4** | **4,347.4** | **3,578.0** |

FRS 29, 39

A maturity analysis for non-derivative financial liabilities showing the remaining contractual maturities should be given, together with a description of how the liquidity risk is managed. A maturity analysis is required for derivative financial liabilities which shall be on a contractual maturity basis where that is essential for an understanding of the timing of the cash flows.

FRS 29, B10A

An entity shall explain how the summary quantitative data disclosed in respect of liquidity risk are determined. If the outflows of cash (or another financial asset) included in those data could either:

a) occur significantly earlier than indicated in the data, or
b) be for significantly different amounts from those indicated in the data (e.g. for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement),

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses.

FRS 29, B11D

Analysis by contractual maturity should include undiscounted cash flows. As a result, the cash flows will differ from the amount included in the balance sheet as the balance sheet amount is based on discounted cash flows. No reconciliation is required.

FRS 29, B11C(a)

When there is a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the entity can be required to pay. Insurance entities will need to consider the time band into which the earliest contractual repayment date for financial liabilities under investment contracts would fall.

PwC

There is no requirement to provide a maturity analysis of liabilities under insurance contracts as they do not fall within the scope of FRS 29, although some companies may choose voluntarily to disclose this information as best practice. Proforma-Gen has elected to disclose this information to enable users of its financial statements to evaluate the liquidity risk of the liabilities under insurance contracts, which represents a large proportion of the entity's total liabilities.

FRS 29, B11E

PwC

There is a requirement that a maturity analysis of financial assets held for managing liquidity risk be given if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk (e.g. financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities). Financial institutions typically use financial assets to manage their liquidity risk. In these circumstances, the information is likely to be necessary to enable users of financial statements to evaluate the nature and extent of liquidity risk, in which case we would expect them to present a maturity analysis of financial assets.

PwC

Proforma-Gen has disclosed the maturity analysis of financial assets, as it is deemed to be necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk (including the liquidity risk in respect of outstanding claims which Proforma-Gen has chosen to include in the maturity analyses tables).

FRS 29, B11C(b)

When an entity is committed to making payments by instalments, each instalment is allocated to the earliest period in which the entity can be required to pay.

FRS 29, B11F

In preparing the liquidity risk analysis, entities may consider whether they:

- have committed borrowing facilities (e.g. commercial paper facilities) or other lines of credit (e.g. stand-by credit facilities) that can be accessed to meet liquidity needs;
- hold deposits at central banks to meet liquidity needs;
- have very diverse funding sources;
- have significant concentrations of liquidity risk in either assets or its funding sources;

- have internal control processes and contingency plans for managing liquidity risk;
- have instruments that include accelerated repayment terms (e.g. on the downgrade of credit rating);
- have instruments that could require the posting of collateral (e.g. margin calls for derivatives);
- have instruments that allow a choice as to whether financial liabilities are settled by delivering cash (or another financial asset) or by delivering own shares; or
- have instruments that are subject to master netting agreements.

### *(d) Capital management*

FRS 29, 42I, E1, E2

Proforma-Gen Limited maintains an efficient capital structure from a combination of equity shareholders' funds and borrowings, consistent with the Group's risk profile and the regulatory and market requirements of its business.

The Group's objectives in managing its capital are:

- to match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- to maintain financial strength to support new business growth;
- to satisfy the requirements of its policyholders, regulators and rating agencies;
- to retain financial flexibility by maintaining strong liquidity and access to a range of capital markets;
- to allocate capital efficiently to support growth; and
- to manage exposures to movement in exchange rates.

An important aspect of the Group's overall capital management process is the setting of target risk-adjusted rates of return for individual business units, which are aligned to performance objectives and ensure that the Group is focused on the creation of value for shareholders.

The Group has a number of sources of capital available to it and seeks to optimise its debt to equity structure in order to ensure that it can consistently maximise returns to shareholders. The Group considers not only the traditional sources of capital funding but the alternative sources of capital including reinsurance and securitisation, as appropriate, when assessing its deployment and usage of capital. The group manages as capital all items that are eligible to be treated as capital for regulatory purposes.

Insurance entities within the Proforma-Gen group are regulated by the Prudential Regulation Authority and the Group and those regulated entities are subject to insurance solvency regulations which specify the minimum amount and type of capital that must be held in addition to the insurance liabilities. The Group manages capital in accordance with these rules and has embedded in its ALM framework the necessary tests to ensure continuous and full compliance with such regulations. The Group is subject to the PRA's Group capital adequacy requirements (which are based on EU Directive requirements). The Group aims to maintain capital at a level of 200% of these minimum requirements. At 31 December 2013 the total capital available to meet this requirement is approximately £700m (2012: £650m) which exceeds this 200% target. In addition, each regulated entity within the Proforma-Gen Group manages its own regulatory capital by reference to both minimum capital requirements based on EU Directive and also self-assessed risk-based capital determined under the PRA's individual capital adequacy regime. Both the Group and the regulated entities within it have complied with all externally imposed capital requirements throughout the year. In addition, in the UK, general insurers are required to maintain equalisation provisions in respect of certain classes of business to protect against the impact of large claims and catastrophes. The basis on which these equalisation provisions are established is set out in regulations. The amount of equalisation provision is set out in Note 25.

FRS 29, E1, E2

Disclosures about an entity's capital are required to enable users of its financial statements to evaluate its objectives, policies and processes for managing capital. This includes:

(a) qualitative information about its objectives, policies and processes for managing capital including
  - a description of what it manages as capital;
  - any externally imposed capital requirements and how they are incorporated into the management of capital; and
  - how it is meeting its objectives;

(b) summary quantitative data about what it manages as capital;

(c) any changes from the previous period;

(d) whether it complied with any externally imposed capital requirements to which it is subject; and

(e) if it hasn't complied, the consequences of non-compliance.

FRS 29, EBC12

Quantitative disclosures are not required in respect of externally imposed capital requirements.

***(e) Fair value estimation***

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Group's assets and liabilities measured at fair value at 31 December 2013 and at 31 December 2012.

| 2013 | Level 1 | Level 2 | Level 3 | Total balance |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Assets** | | | | |
| Financial assets at fair value through profit or loss: | | | | |
| - derivatives | - | 37.6 | 12.6 | 50.2 |
| - shares and other variable-yield securities and units in unit trusts | 930.7 | 199.2 | - | 1,129.9 |
| | **930.7** | **236.8** | **12.6** | **1,180.1** |

| 2012 | Level 1 | Level 2 | Level 3 | Total balance |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Assets** | | | | |
| Financial assets at fair value through profit or loss: | | | | |
| - derivatives | - | 42.8 | 2.9 | 45.7 |
| - shares and other variable-yield securities and units in unit trusts | 874.3 | 205.5 | - | 1,079.8 |
| | **874.3** | **248.3** | **2.9** | **1,125.5** |

FRS 29, 27B

The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date as described in the accounting policy I. These instruments are included in Level 1. Instruments included in Level 1 comprise primarily FTSE listed equity investments.

The Group closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. The relative weightings given to differing sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement.

If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- The use of observable prices for recent arm's length transactions.
- Quoted market prices or dealer quotes for similar instruments.
- For forward foreign exchange contracts, the use of observable forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis and other pricing models having regard to the valuation guidelines given by the British Venture Capital Association, the European Private Equity and Venture Capital Association and the Association Française des Investisseurs en Capita.

All of the resulting fair value estimates are included in Level 2 except for certain forward foreign exchange contracts as detailed below.

FRS 29, 27B(b)

In 2013, £25.6m of variable-yield securities were transferred from Level 2 into Level 1. This is because that instrument was regarded as inactive in the market in prior year is now actively traded in the market during the year. There were no transfers between Level 2 and Level 1 in 2012.

FRS 29, 27B(c)

The following table presents the changes in Level 3 instruments for the year ended 31 December.

| | Derivatives | |
|---|---|---|
| | 2013 | 2012 |
| | £m | £m |
| Opening balance | 2.9 | 1.2 |
| Purchase during the year | 1.3 | 1.5 |
| Transfer into Level 3 | 7.0 | - |
| Gains and losses recognised in the profit or loss | 1.4 | 0.2 |
| **Closing balance** | **12.6** | **2.9** |
| Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period | 1.4 | 0.2 |

In 2013, the Group transferred a held-for-trading foreign exchange swap contract from Level 2 into Level 3. This is because the counterparty for the derivative encountered significant financial difficulties, which resulted in a significant increase to the discount rate due to increased counterparty credit risk, which is not based on observable inputs.

FRS 29, 27A, 27B

Each class of financial instrument recognised at fair value in the balance shall be analysed in accordance with the following three-level hierarchy:

(a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

(b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2); and

(c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement.

Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

An entity shall disclose:

(a) the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels defined above;

(b) any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.

(c) for fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:

 (i) total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the profit and loss account;

 (ii) total gains or losses recognised through the statement of total recognised gains and losses;

 (iii) purchases, sales, issues and settlements (each type of movement disclosed separately); and

(iv) transfers into or out of Level 3 (e.g. transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

(d) the amount of total gains or losses for the period in (c)(i) above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the profit and loss account.

(e) for fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised through the statement of total recognised gains and losses, total equity. For Proforma-Gen such changes would not be significant.

An entity shall present these quantitative disclosures in tabular format unless another format is more appropriate.

These disclosure requirements relate to financial instruments (both assets and liabilities) within the scope of FRS 29 that are held at fair value in the balance sheet. They do not encompass financial instruments that are not held at fair value (e.g. those measured at amortised cost).

## 2 Segmental analysis

### *(a) Gross premiums written and gross premiums earned by class of business*

Sch3, 85(1)

| | Gross premiums written | | Gross premiums earned | |
|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** |
| | **£m** | **£m** | **£m** | **£m** |
| **Direct insurance** | | | | |
| Motor | | | | |
| – Third-party liability | **58.1** | 47.9 | **55.3** | 50.6 |
| – Other – acquisition (FRS 3, 15) | **40.3** | – | **10.7** | – |
| - other continuing operations | **517.1** | 481.8 | **495.2** | 532.8 |
| Accident and health | **117.3** | 89.4 | **120.2** | 91.7 |
| Third-party liability | **117.8** | 106.8 | **109.7** | 103.2 |
| Fire and other damage to property | **238.7** | 242.1 | **250.2** | 219.8 |
| | **1,089.3** | 968.0 | **1,041.3** | 998.1 |
| **Reinsurance acceptances** | | | | |
| Marine | **391.4** | 320.6 | **413.1** | 320.6 |
| Aviation (discontinued) (FRS 3, 15) | **(5.8)** | 117.3 | **(5.8)** | 117.3 |
| | **1,474.9** | 1,405.9 | **1,448.6** | 1,436.0 |

Sch3, 85(1)

*(b) Gross claims incurred, gross operating expenses and the reinsurance balance by class of business*

| | Gross claims incurred | | Gross operating expenses | | Reinsurance balance | |
|---|---|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** | **2013** | **2012** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| **Direct insurance** | | | | | | |
| Motor | | | | | | |
| – Third-party liability | **44.8** | 41.2 | **17.1** | 15.2 | **0.1** | (1.3) |
| – Other – acquisition | **6.1** | – | **2.1** | - | **0.1** | – |
| – other continuing operations (FRS 3, 15) | **447.3** | 498.1 | **148.9** | 128.3 | **10.4** | (9.2) |
| Accident and health | **88.0** | 73.4 | **38.4** | 30.2 | **(1.2)** | (1.3) |
| Third-party liability | **70.7** | 69.4 | **34.2** | 25.3 | **(0.8)** | 0.1 |
| Fire and other damage to property | **143.2** | 174.4 | **76.1** | 68.1 | **3.8** | (2.1) |
| | **800.1** | 856.5 | **316.8** | 267.1 | **12.4** | (13.8) |
| **Reinsurance acceptances** | | | | | | |
| Marine | **361.0** | 262.5 | **93.4** | 70.9 | **8.5** | (2.9) |
| Aviation (discontinued) (FRS 3, 15) | **(2.2)** | 135.9 | **1.1** | 25.2 | **0.1** | 7.3 |
| | **1,158.9** | 1,254.9 | **411.3** | 363.2 | **21.0** | (9.4) |

The reinsurance balance represents the credit/(charge) to the technical account from the aggregate of all items relating to reinsurance outwards.

**Segmental analysis by class of business**

Sch3, 85(3)

***Schedule 3 disclosures***

Segmental analysis by class of business is required to be made in respect of direct insurance business when the amount of gross premiums written for a particular class, as defined in Schedule 3, exceeds 10 million euros. If a company has fewer than three classes of business meeting this criterion, disclosure is required in any case of the three largest classes.

The classes defined in Schedule 3 are as follows:

- Accident and health
- Motor (third-party liability)
- Motor (other classes)
- Marine, aviation and transport
- Fire and other damage to property
- Third-party liability
- Credit and suretyship
- Legal expenses
- Assistance
- Miscellaneous.

Sch3, 85(2)

***Analysis by way of direct insurance and reinsurance acceptances***

Where reinsurance inwards business is undertaken, reinsurance acceptances are required to be analysed if they amount to 10% or more of gross premiums written.

ABI, 264

***Reinsurance balance***

Schedule 3 requires disclosure of the "reinsurance balance". This is defined in the ABI SORP as the aggregate total of all those items included in the technical account for general business which relate to reinsurance outwards transactions including reinsurance commission and profit participation.

Sch6, 40(6)
ABI, 220

***Application to group financial statements***

The disclosures given above are only mandatory in respect of insurance company (as opposed to group) financial statements. These illustrative financial statements include such disclosures both to aid users preparing unconsolidated entity financial statements and as indicative of the types of disclosures that may be voluntarily made in group financial statements.

SSAP 25, 34

**SSAP 25 and class of business analysis**

Under SSAP 25 certain disclosures by class of business are required, namely turnover, profit and net assets.

SSAP 25, 30

The definition of class of business in SSAP 25 is "a distinguishable component of an entity that provides a separate product service or a separate group of related products or services".

PwC

In most cases insurance companies have determined general insurance to be one class of business and life assurance another under SSAP 25. As a result, no additional class of business analysis is given.

***(c) Analysis by geographic area***

SSAP 25, 34
Sch3, 87(1)

| | Gross written premiums | | Profit/(Loss) before taxation and minority interests | | Net assets | |
|---|---|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** | **2013** | **2012** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| **United Kingdom** | | | | | | |
| Acquisitions (FRS 3, 15) | **40.3** | - | **3.2** | - | **51.2** | - |
| Other continuing operations | **1,366.2** | 1,219.3 | **91.5** | 67.4 | **772.2** | 688.2 |
| Discontinued operations (FRS 3, 15) | **(5.8)** | 117.3 | **(0.5)** | (31.1) | **9.2** | 77.0 |
| | **1,400.7** | 1,336.6 | **94.2** | 36.3 | **832.6** | 765.2 |
| **United States** | | | | | | |
| Direct insurance | **74.2** | 69.3 | **(3.8)** | (5.7) | **47.4** | 40.3 |
| | **1,474.9** | 1,405.9 | | | **880.0** | 805.5 |
| Short-term fluctuations in investment return (ABI, 308) | | | **55.2** | (58.8) | | |
| Loss on discontinuance of operations | | | **-** | (24.8) | | |
| As reported in non-technical account | | | **145.6** | (53.0) | | |

SSAP 25, 34
Sch3, 87(1)

Gross written premiums by destination are not materially different to those by origin. Of the premiums written in the United Kingdom, £1,014.5m (2012: £898.7m) relate to direct insurance.

**Segmental analysis by geographical area**

***Schedule 3 disclosures***

Sch3, 87(1)

Where overseas business is conducted, a geographical analysis of gross direct premiums is required resulting from contracts concluded:

(a) in the EU member State of a company's head office;

(b) in other EU member States; and

(c) in other countries.

The disclosure is only required where such amounts for each area exceed 5% of total gross premiums. The disclosure is only mandatory in entity, as opposed to group, financial statements.

***SSAP 25 disclosures***

SSAP 25, 34

SSAP 25 requires that turnover, the result before tax, minority interest and extraordinary items, and net assets be disclosed by origin of the business (i.e., geographical segment). In addition, turnover should be disclosed by destination or a statement made that this is not materially different to turnover by origin.

ABI, 308

Where allocations of investment return are made, based on the longer-term rate of investment return the profit before tax of each segment shown in the segmental analysis should be based on the longer-term investment return and reconciled to the actual result before tax disclosed in the non-technical account.

See commentary to the technical account for a discussion of what constitutes turnover in a general insurer.

SSAP 25, 26
FRS 9, 27

Where interest in associated undertakings account for at least 20% of in reporting entity's total result or net assets, the segmental analysis of profit and net assets is required to separately identify the amounts in respect of the interests in associated undertakings. Such an analysis in respect of turnover is only required where the reporting entity has taken up the option in FRS 9 to disclose its share of its associates' turnover as a memorandum item on the face of the profit and loss account.

***Acquisitions and disposals***

FRS 3, 15
FRS 6, 28

Where acquisitions or disposals have material effects on major business segments the impact should be disclosed and explained in the segmental analysis.

FRS 3, 14

## 3 Analysis of profit and loss account items

Discontinued operations relate to aviation business, which the company ceased writing on 31 December 2012.

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Continuing** | **Discontinued** | **Total** | **Continuing** | **Discontinued** | **Total** |
| | £m | £m | £m | £m | £m | £m |
| Earned premiums, net of reinsurance | **1,311.7** | **(5.8)** | **1,305.9** | 1,223.6 | 101.3 | 1,324.9 |
| Allocated investment return transferred from the non-technical account | **212.6** | **4.1** | **216.7** | 197.7 | 4.3 | 202.0 |
| Claims incurred, net of reinsurance | **(1,014.5)** | **2.3** | **(1,012.2)** | (1,050.6) | (114.7) | (1,165.3) |
| Changes in other technical provisions | **(17.8)** | **–** | **(17.8)** | – | – | – |
| Net operating expenses | **(393.2)** | **(1.1)** | **(394.3)** | (328.0) | (23.1) | (351.1) |
| Other technical charges, net of reinsurance | **(1.2)** | **–** | **(1.2)** | – | – | – |
| Change in the equalisation provision | **(9.4)** | **–** | **(9.4)** | (9.9) | 1.1 | (8.8) |
| **Balance on the technical account for general business** | **88.2** | **(0.5)** | **87.7** | 32.8 | (31.1) | 1.7 |
| Investment income | **256.3** | **4.9** | **261.2** | 182.7 | 4.0 | 186.7 |
| Unrealised gains on investments | **31.1** | **0.6** | **31.7** | – | – | – |
| Investment expenses and charges | **(20.7)** | **(0.3)** | **(21.0)** | (25.2) | (0.4) | (25.6) |
| Unrealised losses on investments | **-** | **-** | **-** | (17.5) | (0.4) | (17.9) |
| Allocated investment return transferred to the general business technical account | **(212.6)** | **(4.1)** | **(216.7)** | (197.7) | (4.3) | (202.0) |
| Other finance income | **2.2** | **–** | **2.2** | 3.3 | – | 3.3 |
| Other income | **20.5** | **–** | **20.5** | 49.1 | – | 49.1 |
| Other charges | **(20.0)** | **–** | **(20.0)** | (23.5) | – | (23.5) |
| **Total Group operating profit** | **145.0** | **0.6** | **145.6** | 4.0 | (32.2) | (28.2) |

The figures for continuing operations in the period include the following amounts relating to acquisitions: net earned premiums of £10.5m, net claims incurred of £5.9m, net operating expenses of £2.0m, other technical charges of £1.2m, investment income of £3.6m, unrealised gains on investments of £0.4m, investment expenses and charges of £0.2m and other charges of £1.2m.

The investment income allocated from the non-technical account to the technical account in respect of the acquisition was £3.0m and the relevant element of the balance on the technical account, for general business was £4.4m.

PwC

In the year of acquisition it is appropriate that any amortisation of the total goodwill arising on the acquisition should be attributed to results of acquisitions. This reflects the fact that, from a group position, the amortisation is a cost of the acquisition and this maintains comparability between the results attributable to continuing operations other than acquisitions. The figures in respect of the acquisition disclosed as other technical charges and other charges represent the amortisation charge for the year.

## 4 Movement in prior year's provision for claims outstanding

An adverse run-off deviation of £17.9m was experienced during the year in respect of marine treaty reinsurance acceptances (2012: positive run-off deviation of £8.7m in respect of motor business).

Sch3 PL (4)

ABI, 103

ABI, 112

The requirement of Schedule 3 to disclose any material surplus or deficiency in claims provisions established at the previous year-end also includes the need to analyse the surplus/deficiency by category. Materiality in this context is judged by reference to the business as a whole and not to individual categories of business. The effect of the unwinding of the discount in respect of discounted claims should be ignored in considering whether material run-off deviations have arisen.

PwC

The comparatives given are the figures that were disclosed in the prior year's note rather than comparatives in respect of classes for which material deviations have occurred in the current year.

## 5 Net operating expenses

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Acquisition costs | **313.8** | 285.6 |
| Change in deferred acquisition costs | **(14.3)** | (8.9) |
| Administrative expenses | **105.5** | 87.6 |
| Reinsurance commissions and profit participation | **(17.0)** | (12.1) |
| | **388.0** | 352.2 |

ABI, 221

***General business levies***

Levies raised by the Financial Services Compensation Scheme (FSCS) and by the Motor Insurers' Bureau (MIB) should be included within administrative expenses. The requirements regarding providing for such levies are discussed in the commentary to Note 27 below.

Sch3, 88

Total commissions for direct insurance accounted for by the Group during the year amounted to £153.6m (2012: £144.8m).

Sch6, Pt 3, 40(6)

ABI, 218

The disclosure of total commission for direct insurance is not strictly required in group financial statements. It is included here for illustrative purposes.

The amount should exclude any commissions payable to employees.

## 6 Auditor remuneration

SI2008/489 (as amended by SI2011/2198)

ICAEW Tech 04/11

During the year the Group obtained the following services from the Company's auditor and its associates:

| | 2013 | 2012 |
|---|---|---|
| | £'000 | £'000 |
| Fees payable to the Company's auditor and its associates for the audit of the parent Company and consolidated financial statements | **833** | 943 |
| Fees payable to the Company's auditor and its associates for other services: | | |
| The audit of the Company's subsidiaries | **87** | 82 |
| Audit-related assurance services | **100** | 75 |
| Tax compliance services | **360** | 350 |
| Tax advisory services | **250** | 300 |
| Other assurance services | **227** | – |
| Corporate finance services | **75** | 80 |
| | **1,932** | 1,830 |

| | 2013 | 2012 |
|---|---|---|
| | £'000 | £'000 |
| **Fees in respect of the Proforma-Gen Limited pension scheme:** | | |
| Audit | **43** | 42 |
| Audit-related assurance services | **12** | 11 |
| | **55** | 53 |

SI2008/489 (as amended by SI2011/2198)

The requirements in the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 (SI2008/489 as amended by SI 2011/2198) on disclosure of auditor remuneration, apply to all financial statements with the following exceptions:

- Where a parent company is required to (and does) prepare consolidated financial statements, there is no requirement to disclose, in addition to the group audit fee, the audit fee for the company.
- Large companies disclose the audit fee receivable by the auditor and its associates; small and medium-sized companies disclose the audit fee receivable by the auditor only.
- The disclosures in respect of fees for 'Other services' are not required to be given by:
    - small or medium companies or groups (reduced disclosure requirements apply);
    - subsidiary companies in their individual financial statements, whose parents are required to, and do, prepare consolidated financial statements in accordance with the Companies Act 2006 and the subsidiary company is included in the consolidation; or
    - parent companies in their individual financial statements, where the company is required to, and does, prepare consolidated financial statements in accordance with the Companies Act 2006.
- The disclosure in respect of fees for 'Other services' provided by a distant associate of the company's auditor are not required if the total remuneration receivable for all of those services supplied by that associate does not exceed £10,000 or, if higher, 1% of the total audit remuneration received by the company's auditor in the most recent financial year of the auditor.

The statutory requirements in relation to auditors' remuneration are supported by guidance published by the ICAEW in Tech 04/11, 'Disclosure of Auditor Remuneration', which also provides example disclosures.

Disclosure is required in the parent company's group and individual financial statements in respect of fees paid in the following categories:

- fees payable to the company's auditor and its associates for the audit of the parent and consolidated financial statements; and

- fees payable to the company's auditor and its associates from the company and its associates for other services including:
    - audit of accounts of any associate of the company ;
    - audit-related assurance services;
    - taxation compliance services;
    - all other taxation advisory services;
    - internal audit services;
    - all other assurance services;
    - services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the company or any of its associates; and
    - all other non-audit services.

Separate disclosure is required of:

- fees in respect of the company and its subsidiaries; and
- fees in respect of company pension schemes.

The 'company and its associates' refers to the subsidiaries of the company, and not to its associates as defined in FRS 9, 'Associates and joint ventures'. Similarly, references to the 'Auditor and its associates' refer to members of the same network of firms as the company's auditor.

Where fees for services performed by other parts of the audit firm that assist in the audit are invoiced either as part of, or separately from, the audit fee, those fees are included within the audit fees disclosed.

The above disclosure requirements will still apply to parent company's individual financial statements where it chooses to take advantage of section 401 Companies Act 2006 exemption from consolidation for intermediate holding companies within a group headed by a non-EEA parent company (where the financial statements are drawn up in accordance with the Insurance Accounts Directive or in an equivalent manner).

## 7 Operating lease rentals

SSAP 21, 55

| | 2013 | 2012 |
|---|---|---|
| | **£m** | **£m** |
| Plant and machinery | **3.2** | 2.7 |
| Other leases | **10.4** | 9.8 |
| | **13.6** | 12.5 |

## 8 Staff costs

s411(5)

| **Group** | 2013 | 2012 |
|---|---|---|
| | **£m** | **£m** |
| Wages and salaries | **145.7** | 119.5 |
| Social security costs | **8.6** | 8.5 |
| Other pension costs | **7.4** | 7.8 |
| | **161.7** | 135.8 |

s411(1)

The average number of employees (including executive directors) of the Group during the year was as follows:

| | 2013 | 2012 |
|---|---|---|
| | **No.** | **No.** |
| Administration and finance | **2,341** | 2,224 |
| Underwriting | **3,741** | 3,128 |
| Claims | **1,183** | 974 |
| Investments | **127** | 111 |
| | **7,392** | 6,437 |

The Company has no employees.

**Employee numbers**

s411(2)

The Companies Act 2006 requires an analysis of average number of employees having regard to the manner in which the company's activities are organised.

**FRS 20 'Share-based payment'**

The standard applies to all share-based payment transactions, which fall into three broad types:

- equity-settled share-based payment transactions – Transactions in which an entity receives goods or services, including employee services, as consideration for its own equity instruments. Such transactions include employee share option and share incentive plans;
- cash-settled share-based payment transactions – Transactions in which an entity acquires goods or services by incurring liabilities (typically to be settled in cash), but where the amount paid is based on the value of the entity's shares or other equity instruments. Typical examples include 'phantom' share schemes, share appreciation rights and certain long-term incentive schemes; and
- transactions in which either party may choose settlement in the form of cash (or other assets) or equity instruments of the entity.

***Recognition of share-based payment transactions***

The goods or services acquired in a share-based payment transaction should be recognised when they are received. For an equity-settled transaction, the corresponding entry will be within equity (shareholders' funds). For cash-settled transactions a liability will be recognised.

***Measurement of equity-settled share-based payment transactions***
The measurement objective of FRS 20 is to determine the fair value of the goods or services acquired by an entity. If the fair value of goods and services cannot be measured reliably, it should be measured indirectly by reference to the fair value of the equity instruments granted in consideration.

***Vesting conditions***
Vesting conditions are conditions that must be satisfied before a counterparty becomes unconditionally entitled to the equity instruments or payment to which they relate. Where equity instruments vest immediately, in the absence of evidence to the contrary, an entity should presume that they represent consideration for goods already received or services already rendered. In this case, on the date on which the options are granted the entity should recognise the goods or services received in full. However, if there is a specified period of service over which an award vests, the goods or services should be recognised over that vesting period.

***Cash-settled share-based payment transactions***
Expenses in respect of cash-settled share-based payment transactions should be recognised over the period during which goods are received or services are rendered and measured at the fair value of the liability. Unlike equity-settled transactions, the fair value of the liability should be re-measured at each reporting date until settled. Changes in fair value are recognised in the profit and loss account. Unlike equity-settled share-based payment transactions, the credit entry in respect of a cash-settled share-based payment transaction is presented as a liability.

***Share-based payment transactions with alternative methods of settlement***
Sometimes either the reporting entity or the counterparty has a choice as to whether to settle a share-based payment transaction in cash or with an issue of equity instruments.

Where the counterparty has the choice of settlement method, the standard concludes that the reporting entity has issued a compound financial instrument, comprising a debt component (the counterparty's right to demand payment in cash) and an equity component (the counterparty's right to demand settlement in equity instruments). There are detailed rules on the valuation and subsequent treatment of the instrument's debt and equity parts.
Where the reporting entity has the choice, the transaction should be treated as cash-settled if the option to settle in equity is not substantive or if the entity has a past practice or a stated policy of settling in cash. Otherwise, the transaction should be treated as equity-settled. Adjustments will then be necessary if the chosen method of settlement does not match the method of accounting.

***Share-based payment arrangements involving equity instruments of the parent***

UITF 44

UITF 44 provides guidance on how to account for share-based payment arrangements that involve two or more entities within the same group. For example, where employees of a subsidiary are granted rights to equity instruments of its parent as consideration for the services provided to the subsidiary.

The accounting for such share-based payment arrangements hinges around which entity grants the award and therefore has the obligation to settle. When a parent entity grants rights over the parent’s equity instruments to the employees of its subsidiary, as long as the share-based payment arrangement is accounted for as equity-settled in the consolidated financial statements, the subsidiary should treat the arrangement as an equity-settled arrangement (with the other side of the FRS 20 being a credit to equity that is not subject to subsequent re-measurement. Conversely, where a subsidiary grants rights over the parent’s equity instruments to the subsidiary’s employees, the subsidiary is required to account for the transaction as cash-settled and will, therefore, recognise a liability (re-measured at each balance sheet date) as the other side of the FRS 20 charge.

UITF 38

UITF 32

***Disclosures***

The standard requires extensive disclosure under three broad headings:

- the nature and extent of share-based payment arrangements that existed during the period;
- how the fair value of the goods or services received, or the fair value of the equity instruments granted during the period, was determined; and
- the effect of expenses arising from share-based payment transactions on the entity's profit or loss for the period.

***Employee share ownership plans and similar arrangements***

FRS 20 deals only with the expense of share based payments and not with the accounting for assets and liabilities of employee share ownership plans. Guidance exists instead in UITF Abstract 38 'Accounting for ESOP trusts', which provides that where an entity has de facto control of an ESOP trust, certain of the ESOP's assets and liabilities should be brought back onto the entity's balance sheet. This is on the basis that, for all practical purposes, the sponsoring entity is in the same position as if it had purchased the shares directly and, therefore, should account for them in a similar way.

The UITF applied similar principles when it considered other arrangements involving employee benefit trusts. The resultant guidance in UITF Abstract 32, 'Employee benefit trusts and other intermediate payment arrangements', requires that when an entity transfers funds to an intermediary, there should be a rebuttable presumption that the sponsoring entity has exchanged one asset for another and that the payment itself does not represent an immediate expense. Hence, as for an ESOP trust, an employee benefit trust is treated as if it was an extension of the reporting entity itself.

Proforma-Gen Limited has no share-based payments under FRS 20.

## 9 Directors' emoluments

| | | 2013 | 2012 |
|---|---|---|---|
| | | **£'000** | **£'000** |
| Sch5, 1(1) (a) | Aggregate emoluments | **468** | 418 |
| Sch5, 1(1) (c) | Aggregate amounts receivable under long-term incentive schemes | **217** | 239 |
| Sch5, 4(1) | Compensation for loss of office (excluding shares) | **–** | 50 |
| Sch5, 5(1) | Sums paid to third parties for directors' services | **20** | 18 |
| | Excess retirement benefits | | |
| Sch5, 3(1) (a) | – current directors | **20** | 15 |
| Sch5, 3(1) (b) | – past directors | **15** | 10 |
| | | **740** | 750 |

Sch5, 1(2)

Retirement benefits are accruing to five directors (2012: five) under the Group's defined benefit pension scheme.

Sch5, 1(3)(b), Sch5, 2(3)

No directors exercised share options or received shares in respect of qualifying services under any long term incentive scheme.

s413(2)

No advances or credits granted to any director subsisted during the year. Also, no guarantees on behalf of any director subsisted during the year.

**Highest paid director**

| | | 2013 | 2012 |
|---|---|---|---|
| | | **£'000** | **£'000** |
| Sch5, 2(1) (a) | Aggregate emoluments and benefits (excluding shares) under long-term incentive schemes | **141** | 117 |
| Sch5, 2(2) | Defined benefit pension scheme: Accrued pension at the end of year (per annum) | **65** | 63 |

Sch5, 1(3)(b)

Where applicable, the number of directors who exercised share options in the year and the number of directors who have become entitled to receive shares under any long-term incentive schemes are required to be disclosed.

Sch5, 2(1)

Sch5, 2(2) (b)

The highest paid director's disclosures are only required to be given where the aggregate of directors' emoluments and benefits under long-term incentive schemes exceeds £200,000. If the highest paid director is entitled to a lump sum payment on attaining normal pensionable age, the amount accrued at the balance sheet date is required to be disclosed.

Sch5, 2(3)

A non-listed entity must state whether the highest paid director exercised any share options and whether any shares were received or receivable by that director in respect of qualifying services under long term incentive schemes.

s413(2), (3)

Where applicable, the amounts and interest rate on any advances or credits granted to the directors by the company or by any of its subsidiary undertakings are required to be disclosed. The main conditions of those advances or credits and amounts repaid are also required to be disclosed.

s413(2), (4)

Where applicable, the main terms and the amounts of maximum liability in respect of guarantees of any kind entered into on behalf of the directors, by the company or by any of its subsidiary undertakings are required to be disclosed. Any amounts paid and any liability incurred by the group, in respect of those guarantees, are also required to be disclosed.

## 10 Investment return

| Reference | | 2013 | 2012 |
|---|---|---|---|
| | | **£m** | **£m** |
| | **Investment income** | | |
| | Income from other financial investments: | | |
| FRS 29, 20(a)(iii) | - Held-to-maturity interest income | **54.3** | 59.1 |
| FRS 29, 20(a)(iv) | - Loans and receivables interest income | **18.7** | 18.3 |
| FRS 29, 20(b) | Total interest income on financial assets not at fair value through profit and loss | **73.0** | 77.4 |
| | Income from financial assets at fair value through profit and loss | **90.2** | 94.6 |
| | | **163.2** | 172.0 |
| | Income from associated undertakings | **5.5** | 9.5 |
| | Income from land and buildings | **6.9** | 5.2 |
| | Net gains on the realisation of investments | **85.6** | – |
| | | **261.2** | 186.7 |
| | **Investment expenses and charges** | | |
| FRS 29, 20(a)(v) & (b) | Interest payable on financial liabilities, at amortised cost | **(13.5)** | (13.0) |
| | Other investment management expenses | **(7.5)** | (7.6) |
| | Total investment management expenses, including interest | **(21.0)** | (20.6) |
| | Net losses on the realisation of investments | **–** | (5.0) |
| | | **(21.0)** | (25.6) |
| | **Net unrealised gains / (losses) on investments** | **31.7** | (17.9) |
| ABI, 230 | **Other finance income – net return on defined benefit pension scheme** | **2.2** | 3.3 |
| | **Total investment return** | **274.1** | 146.5 |
| FRS 29, 20(a)(i) | Included in the total investment return are net gains or losses on financial assets at fair value through profit or loss: | | |
| | Assets designated upon initial recognition: | **191.2** | 63.9 |
| | Assets held for trading | **10.4** | 5.4 |
| | **Net gains / (losses) on financial assets at fair value through profit or loss** | **201.6** | 69.3 |
| | Investment return is analysed between: | | |
| | Allocated investment return transferred to the general business technical account | **216.7** | 202.0 |
| | Net investment return included in the non-technical account | **57.4** | (55.5) |
| | **Total investment return** | **274.1** | 146.5 |

Sch3, 83

Interest payable on financial liabilities at amortised cost comprises £6.4m (2012: £5.9m) in respect of bank loans and overdrafts and £7.1m (2012: £7.1m) in respect of other loans made to the company.

ABI, 305

A 1% increase/decrease in the longer-term rate of investment return would result in an increase/decrease in longer-term investment return of £30.1m (2012: £27.7m).

FRS 29, 20

FRS 29 requires disclosure of the following items of income, expense, gains and losses either on the face of the financial statements or in the notes;

(a) net gains or net losses on:
  - (i) financial assets or financial liabilities at fair value through profit or loss, showing separately those relating to assets designated upon initial recognition and those held for trading;
  - (ii) available-for-sale assets;
  - (iii) held-to-maturity investments;
  - (iv) loans and receivables; and
  - (v) financial liabilities at amortised cost;

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets and liabilities not at fair value through profit or loss;

(c) fee income and expense (other than in (b) above) arising from assets or liabilities not at fair value through profit or loss and trust and fiduciary activities that result in the holding of assets on behalf of individuals, trusts, retirement benefit plans and other institutions;

(d) interest income on impaired assets; and

(e) the amount of any impairment loss for each class of financial asset.

ABI, 305

| | 2009 – 2013 | 2008 – 2012 |
|---|---|---|
| | £m | £m |
| **Investment returns over past five years** | | |
| Actual return attributable to shareholders | **927.3** | 769.2 |
| Longer-term return credited to operating results: | **904.7** | 811.7 |
| **Excess/(deficit) of actual returns over longer-term returns** | **22.6** | (42.5) |

## 11 Other technical income and other income

Other technical income in the technical account comprises fees for policy administration arising from financial liabilities on investment contracts, carried at amortised cost.

FRS23, 52(a)

Included within other income in the non-technical account are foreign exchange gains of £2.5m (2012 £0.6m).

## 12 Taxation

FR16, 17

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| UK corporation tax at 23.25% (2012: 24.5%) | | |
| Current tax on income for the period (Sch3, 84) | **33.0** | (11.1) |
| Adjustments in respect of prior periods | **(2.7)** | 0.8 |
| | **30.3** | (10.3) |
| Double taxation relief (Sch3, 84(2)) | **(0.4)** | (0.3) |
| | **29.9** | (10.6) |
| Foreign tax – Current tax on income for the period (Sch3, 84(2)) | **1.2** | 1.1 |
| Total current tax | **31.1** | (9.5) |
| Deferred tax | | |
| - Origination and reversal of timing differences (FRS 19, 60(a)(i)) | **26.9** | (8.8) |
| - Impact of change in UK tax rate (FRS 19, 60(a)(i)) | **(3.8)** | (1.8) |
| Total deferred tax | **23.1** | (10.6) |
| **Tax on profit on ordinary activities** | **54.2** | (20.1) |

FRS 9, 27

The tax charge for the year includes an amount of £1.7m (2012: charge of £2.9m) in respect of the Group's associated undertaking.

FRS 3, 20

The tax credit for the year ended 31 December 2012 included a credit of £7.8m in respect of the loss on termination of operations.

**Factors affecting the tax charge for the period**

FRS 19, 16

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

FRS 19, 64(a)

| | 2013 | 2012 |
|---|---|---|
| | **£m** | **£m** |
| **Non-technical account** | | |
| **Profit/(loss) on ordinary activities before tax** | **145.6** | (53.0) |
| Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 23.25% (2012: 24.5%) | **33.9** | (13.0) |
| Income not taxable for tax purposes | **(15.5)** | (5.9) |
| Expenses not deductible for tax purposes | **15.2** | 8.5 |
| Higher tax rates on overseas earnings | **0.2** | 0.1 |
| Adjustments to tax charge in respect of previous periods | **(2.7)** | 0.8 |
| **Current tax charge/(credit) for the period** | **31.1** | (9.5) |

**Factors affecting current and future tax charges**

The calculation of deferred tax balances at the year end also takes into account the reduction in the UK main corporation tax rate to 23%, effective from 1 April 2013, and two further reductions to 21% and 20%, substantively enacted on 2 July 2013 that will be effective from 1 April 2014 and 1 April 2015 respectively.

FRS 19, 64

Companies are required to provide a reconciliation between the current tax charge or credit on ordinary activities reported in the profit and loss account to the current tax charge that would result from applying a relevant standard rate of tax to the profit on ordinary activities before tax. This reconciliation may be of either the monetary amounts or the rates (as a percentage of profit on ordinary activities before tax).

**Disclosures**

FRS 3, 23
Sch3, 84(1)
FRS 19, 64

Any special circumstances that affect the overall tax charge or credit for the period, or those that may affect those of future periods, should be disclosed by way of a note to the profit and loss account, and their individual effects quantified.

## 13 Dividends on equity shares

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| **Equity shares** | | |
| 2013 final dividend of 1.65p per share (2012: 3p per share) | **8.0** | **14.6** |

FRS 21, 13

In addition the directors are proposing a final dividend in respect of the financial year ended 31 December 2013 of 2.0p per share, which will absorb an estimated £9.7m of shareholders' funds.

FRS 10, 53
Sch3, 69

## 14 Goodwill – Group

| | Goodwill on acquired claims provisions | Other goodwill | Total |
|---|---|---|---|
| | £m | £m | £m |
| **Cost** | | | |
| Brought forward at 1 January 2013 | – | – | – |
| Acquisition during year | 7.4 | 22.3 | 29.7 |
| **Carried forward at 31 December 2013** | **7.4** | **22.3** | **29.7** |
| **Amortisation** | | | |
| Brought forward at 1 January 2013 | – | – | – |
| Amortisation during year | 1.2 | 1.2 | 2.4 |
| **Carried forward at 31 December 2013** | **1.2** | **1.2** | **2.4** |
| **Net book value – 31 December 2013** | **6.2** | **21.1** | **27.3** |
| – 31 December 2012 | – | – | – |

FRS 10, 55
Sch3, 42

The directors have assessed the useful economic life of the goodwill arising on the acquisition during the period, other than that relating to acquired claims provisions, as 10 years based on the period over which the value of the underlying business acquired is expected to exceed the values of the acquired identifiable net assets.

The useful economic life of goodwill in the acquired claims provisions has been assessed as three years, being the run-off period of the claims arising from the portfolio of business acquired.

Amortisation of goodwill on acquired claims provisions is included in other technical charges in the technical account. Amortisation of other goodwill is included in other charges in the non-technical account.

FRS 10, 71(a)

The cumulative amount of goodwill (net of goodwill attributable to subsequent disposals) previously eliminated against the profit and loss reserve is £17.9m (2012: £17.9m).

ABI, 116

The ABI SORP requires the amortisation of goodwill on acquired claims provisions (see commentary on acquisitions) to be shown as other technical charges within the technical account where an allocation of investment income to the technical account has been made. Where no allocation has been made, the amortisation should be shown as other charges in the non-technical account.

FRRP, PN58

Neither the ABI SORP nor Schedule 3 offer any guidance as to where in the profit and loss account the amortisation of goodwill (other than that relating to acquired claims provision) should be recognised. It is clear, however, following reaffirmation by the FRRP in January 2000 that the amortisation should be charged as part of operating profit.

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In these financial statements, this has been included within 'Other charges' in the non-technical account.

## 15 Land and buildings – Group

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Freehold | **102.2** | 89.3 |
| Long leasehold | **28.2** | 26.3 |
| | **130.4** | 115.6 |

Sch3, 28(3)

The purchase price of land and buildings was £93.7m (2012: £84.7m).

Sch3, BS (4)

Included in land and buildings at market value is £30.3m (2012: £29.2m) in respect of land and buildings occupied by the company for its own use.

Sch3, 70

Land and buildings were valued at 31 December 2013 on an open market existing use basis by Tweed & Co, a firm of independent Chartered Surveyors.

Sch3, 79(4)

Bank borrowings are secured on freehold land and buildings to a value of £12.2m (2012: £28.1m) (Note 28).

## 16 Investment in Group undertakings and participating interests

### *(a) Investments in participating interests – Group*

Sch4, 19
FRS 9, 52
Sch3, 28

The Group has an investment of £36.5m (2012: £34.7m) in an associate company, Thackeray Limited, a company undertaking general insurance business and incorporated in Great Britain. The Group holds 30% of the nominal value of the allotted ordinary shares of Thackeray Limited. None of these shares are held directly by Proforma-Gen Limited. The cost of this investment was £16.1m.

FRS 9, 55

Where there are any amounts owing or owed between an investor and its associates or joint ventures these should be analysed between loans and trading balances.

FRS 9, 57, 58

Certain additional disclosures are required by FRS 9 when associates comprise more than 15% of any of the gross assets, gross liabilities, turnover or operating results of the remainder of the group. The disclosures are further extended if any of the above exceed 25% of the balance of the group's equivalent amount.

SSAP 25, 36

SSAP 25 requires certain segmental analysis in relation to associates where they comprise more than 20% of the group's total assets or result.

### *(b) Investments in Group undertakings – Company*

| | Shares in Group undertakings | Loans to Group undertakings | Total |
|---|---|---|---|
| | £m | £m | £m |
| At 1 January 2013 | 565.7 | 85.9 | 651.6 |
| Acquisitions | 79.9 | – | 79.9 |
| Loan repaid | – | (25.8) | (25.8) |
| **At 31 December 2013** | **645.6** | **60.1** | **705.7** |

Sch4, 1 & 11

Set out below are the company's subsidiaries, all of which undertake general insurance business, as at 31 December 2013, with details of the percentages of nominal value and voting rights held by the Company and the Group.

| Subsidiaries | Class of shares Held | Percentage of nominal value and voting rights held by Company | Percentage of nominal value and voting rights held by Group |
|---|---|---|---|
| Shakespeare Limited | Ordinary | 100 | 100 |
| Dickens Limited | Ordinary | 100 | 100 |
| Chaucer Limited | Ordinary | 75 | 75 |

All subsidiaries are included in the consolidation and are incorporated within Great Britain.

FRS 28, 11 (d)

Corresponding amounts are not required to be disclosed in respect of details of shareholdings in subsidiary undertakings held by a company or, where group accounts are prepared, held by the parent company and by the group.

## 17 Acquisition

FRS 6, 21, 24

On 7 July 2013 the company acquired the whole of the issued share capital of Dickens Limited (a motor insurer) for a cash consideration of £79.9m. The Group has used acquisition accounting to account for the purchase.

FRS 6, 35

The profit on ordinary activities after taxation of Dickens Limited for the period from 1 January 2013 to 6 July 2013 was £3.1m. The profit on ordinary activities after taxation for the year ended 31 December 2012 was £5.2m.

FRS 6, 36 & 37

Further disclosures are required where either the fair value of the consideration exceeds 15% of the acquirer's net assets, or the net assets or operating profit of the acquired undertaking exceeds 15% of those of the acquirer.

The additional disclosures comprise a summarised profit and loss account from the beginning of the acquired undertaking's financial year up to the date of acquisition, together with a statement of total recognised gains and losses for the same period. This information should be based on the acquired undertaking's pre-acquisition-accounting policies.

**Acquired assets and liabilities, fair value adjustments and goodwill**

| | Book value of net assets on acquisition | Alignment of accounting policies | Revaluations | Adjusted net assets |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Assets** | | | | |
| Investments | | | | |
| - land and buildings | 2.3 | - | 3.2 | 5.5 |
| - financial assets | 110.2 | - | - | 110.2 |
| Technical provisions – reinsurers' share | | | | |
| – unearned premiums | 0.2 | – | – | 0.2 |
| – outstanding claims | 3.0 | – | 0.4 | 3.4 |
| Debtors | 13.1 | – | – | 13.1 |
| Other assets | 1.5 | (0.4) | – | 1.1 |
| Prepayments and accruals | 3.8 | – | – | 3.8 |
| **Liabilities** | | | | |
| Technical provisions – gross | | | | |
| – unearned premiums | (25.1) | – | – | (25.1) |
| – outstanding claims | (48.2) | – | (8.4) | (56.6) |
| – equalisation | (0.6) | – | – | (0.6) |
| Creditors | (4.8) | – | – | (4.8) |
| **Net assets/(liabilities)** | 55.4 | (0.4) | (4.8) | **50.2** |
| **Cost of acquisition** | | | | **79.9** |
| **Goodwill arising on acquisition** | | | | **29.7** |

Sch6, 13(3)

FRS 6, 25

The alignment of accounting policies in respect of other assets represents the adjustment required to write off capitalised computer software costs.

The revaluation of investments represents a reassessment of the market value of land and buildings at the date of acquisition.

The revaluation adjustment in respect of outstanding claims represents a reassessment of the level of outstanding claims at the date of acquisition.

ABI, 114 & 115

In accordance with the ABI SORP no fair value adjustment has been made in respect of the timing of payment of outstanding claims. Goodwill arising on acquisition includes an amount of £7.4 million representing the resulting goodwill on acquired claims provisions.

No adjustment has been made to the carrying value of equalisation provisions as their carrying value is determined by statute.

**Claims provisions on acquisition**

ABI, 114

Under the principles of fair value accounting set out in FRS 7, "Fair Values in Acquisition Accounting", when setting fair values consideration should be given to the amounts expected to be paid reflecting the uncertain quantum and timing of future payments.

However, under the Schedule 3, the discounting of claims provisions to reflect the timing of future payments is only permitted in certain limited circumstances.

ABI, 115

The treatment the ABI SORP prescribes is that the fair value of the claims provisions should be calculated in the normal way per FRS 7 but rather than making a discounting adjustment to the fair value of acquired claims provisions, the difference between the discounted and undiscounted amount of the acquired claims provisions should be treated as a separately identified element of goodwill.

ABI, 115

This element of goodwill should be identified separately in the notes to the financial statements and amortised over the run-off period of the claims.

PwC

**Equalisation provisions on acquisition**
Where an acquired entity has established an equalisation provision it could be argued that, under FRS 7, the fair value of that provision is nil as it does not represent a liability at the date of acquisition.

However, such provisions must be carried both in the acquired entity's financial statements and in the consolidated financial statements of the acquirer. As a result of thus including the equalisation provisions as part of the acquired liabilities, the goodwill arising on acquisition is increased. A potential treatment is to separately identify and amortise this additional goodwill in a similar fashion to the goodwill in the acquired provisions. However, in practice it is unlikely to be practical to develop an appropriate amortisation basis to match the amortisation with the release of the acquired equalisation provisions. Therefore in most cases such goodwill will not be separately identified.

PwC

Any transactions with an acquired company prior to the date of acquisition should be disclosed to the extent that they are material in accordance with FRS 8, Related Party Disclosures. There were no transactions between the Proforma-Gen Group and Dickens Limited prior to the date of acquisition.

## 18 Other financial investments – Group

FRS 29, 8
Sch3, 73(3)

| | Carrying Value | | Purchase Price | |
|---|---|---|---|---|
| | **2013** | **2012** | **2013** | **2012** |
| **Financial assets** | **£m** | **£m** | **£m** | **£m** |
| Shares and other variable-yield securities and units in unit trusts<br>- designated at fair value through profit or loss upon initial recognition | **1,129.9** | 1,079.8 | **947.3** | 961.4 |
| Derivative financial instruments<br>- at fair value through profit or loss, held for trading | **50.2** | 45.7 | **38.7** | 36.9 |
| **Financial assets at fair value through profit or loss** | **1,180.1** | 1,125.5 | **986.0** | 998.3 |
| Debt securities and other fixed-income securities<br>- Held- to-maturity, at amortised cost | **1,028.7** | 982.4 | **987.1** | 941.3 |
| Deposits with credit institutions<br>- Loans and receivables | **381.3** | 328.9 | **381.3** | 328.9 |
| **Total financial assets** | **2,590.1** | 2,436.8 | **2,354.4** | 2,268.5 |

FRS 29, 8

FRS 29 requires the carrying amounts of each of the following categories, as defined in FRS 26, to be disclosed either on the face of the balance sheet or in the notes:

(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with FRS 26;

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading in accordance with FRS 26 (see Note 28); and

(f) financial liabilities measured at amortised cost (see Note 28).

Proforma-Gen Limited has no financial assets designated as "available-for-sale".

FRS 29, 15

Where an entity holds collateral of financial or non-financial assets and is permitted to sell or re-pledge the collateral in the absence of default by the owner of the collateral, the fair value of the collateral held should be disclosed, together with the fair value of any collateral sold or pledged and whether the entity has an obligation to return it and also the terms and conditions associated with its use of the collateral.

***(a) Listed investments***

Sch3, 72

Included in the carrying values above are amounts in respect of listed investments as follows:

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Shares and other variable-yield securities and units in unit trusts | **930.7** | 907.4 |
| Debt securities and other fixed-income securities | **853.0** | 784.7 |
| | **1,783.7** | 1,692.1 |

***(b) Derivative financial instruments, at fair value through profit or loss***

FRS 29, 31

To match the expected liability of certain insurance contracts, the Group has purchased over-the-counter ('OTC') currency swap contracts to swap variable exchange rates of the backing assets to fixed exchange rates to meet foreign currency cash flows over the expected period to settlement of the related insurance contracts.

| | Fair value asset | | Contract/notional amount | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| | £m | £m | £m | £m |
| Currency swap contracts – held for trading | **50.2** | 45.7 | **388.7** | 376.9 |

***Derivatives***

Sch3, 73

Where the fair value accounting rules have been used to value derivatives, Sch3 requires the following disclosures:

- the basis of the valuation adopted;
- the purchase price;
- the assumptions used in valuation techniques;
- the fair value and movements recorded in the profit and loss; and
- for each class of derivatives, the extent and nature of the instrument, including significant terms and conditions that may affect the amount, timing and uncertainty of future cash flows.

Sch3, 74

***(c) Held-to-maturity financial assets, at amortised cost***

Sch3, 24

FRS 29, 25
FRS 29, 27

Debt securities and other fixed-interest securities are valued at amortised cost. The fair value of these securities is £979.7m (2012: £1,063.2m). The fair value is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

Sch3, 75(2)

The fair value of debt securities and other fixed-interest securities is £49.0 million below carrying value (2012: £80.8m above). At balance sheet date the Group assessed whether there was objective evidence to impair the carrying value of debt securities and other fixed-interest securities. An exercise was carried out to identify potential evidence to trigger impairment of the assets such as significant financial difficulties of issuers or debtors and disappearance of an active market for the securities and data indicating a measurable decrease in the future cash flow related to the assets in question. However, it was concluded that no objective evidence existed at balance sheet date to prompt impairment of the carrying value. It remains the Group's intention to carry its debt and other fixed-interest securities to maturity.

Sch3, 24(5)

The net excess of the amounts payable at maturity over the amortised cost is £42.1 million (2012: £37.2million).

FRS 29, 20(e)

At the reporting date, there were no held-to-maturity assets that were either impaired or overdue.

**Fair values**

Sch3, 75 (2)
FRS 29, 25, 27

The fair value of each class of financial assets and financial liabilities should be disclosed, together with the methods used in determining fair values (whether in whole or in part, directly by reference to published price quotations in an active market or estimated using a valuation technique). If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.

Sch3, 75 (2)

Where the market value of investments held at amortised cost is less than the carrying value, it is necessary to explain why the carrying value had not been impaired.

FRS 29, 29

Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
(b) for an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with FRS 26 because its fair value cannot be measured reliably; or
(c) for a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.

FRS 29, 30

In the cases described in (b) and (c) above, information is required to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:

(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
(b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
(c) information about the market for the instruments;
(d) information about whether and how the entity intends to dispose of the financial instruments; and
(e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.

**Loans secured by mortgages, other loans and other investments**
Proforma-Gen Limited does not have any amounts falling in the above categories.

Sch3 BS (7)

"Other" investments should comprise those investments that may not sensibly be included in the other investment categories per the balance sheet format. Where such amounts are significant they should be separately disclosed in the notes to the financial statements.

## 19 Tangible assets – Group

Sch3, 38, 69(3)

| | Computer equipment | Motor vehicles | Fixtures, fittings and office equipment | Group |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Book cost** | | | | |
| At 1 January 2013 | 24.9 | 15.8 | 11.9 | 52.6 |
| Additions | 10.1 | 4.6 | 1.9 | 16.6 |
| Acquisitions | 0.2 | – | 0.2 | 0.4 |
| Disposals | (5.4) | (5.8) | (4.2) | (15.4) |
| **At 31 December 2013** (FRS 15, 100(e)) | **29.8** | **14.6** | **9.8** | **54.2** |
| **Depreciation** (Sch3, 38, 69(3)) | | | | |
| At 1 January 2013 | 17.1 | 7.5 | 7.4 | 32.0 |
| Charge for the year (FRS 15, 100(c)) | 8.2 | 3.8 | 1.1 | 13.1 |
| Eliminations in respect of disposals | (3.9) | (4.5) | (1.9) | (10.3) |
| **At 31 December 2013** (FRS 15, 100(f)) | **21.4** | **6.8** | **6.6** | **34.8** |
| **Net book value** | | | | |
| **31 December 2013** (FRS 15, 100(h)) | **8.4** | **7.8** | **3.2** | **19.4** |
| 31 December 2012 | 7.8 | 8.3 | 4.5 | 20.6 |

Sch3, 38(2)

The charge for depreciation for the year ended 31 December 2012 was £12.2m.

FRS 15, 100(d)

If material, the financial effect of a change in estimated useful economic lives or residual values should be disclosed.

FRS 15, 102

When there has been a change in the method of depreciation, any material effect should be disclosed in the period of change. The reason for the change should be disclosed.

FRS 28, 11(a)

Corresponding amounts are not required to be disclosed in relation to details of additions, disposals, revaluations, transfers and cumulative depreciation of fixed assets.

## 20 Deferred acquisition costs

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| On insurance contracts | **135.9** | 122.2 |
| On investment contracts | **7.6** | 7.0 |
| | **143.5** | 129.2 |

## 21 Share capital

Sch3, 65(1)

| | 2013 | 2012 |
|---|---|---|
| **Ordinary shares** | **£m** | **£m** |
| **Allotted, called up and fully paid:** | | |
| 487,650,000 ordinary shares of £1 each | **486.7** | 486.7 |

| | 2013 | 2012 |
|---|---|---|
| **Preference shares** | **£m** | **£m** |
| **Allotted, called up and fully paid:** | | |
| 60,000,000 8% cumulative redeemable preference | **60.0** | 60.0 |

Sch3, 65(2)

The preference shares may be redeemed, at the shareholders' option, between 1 January 2013 and 31 December 2013 at par or, if still outstanding on 31 December 2013, must then be redeemed at par. The shares are non-voting and have a preferential right to return of capital on a winding up.

Preference shares are included within liabilities in accordance with the requirements of FRS 25.

PwC

The disclosures regarding allotted share capital required by paragraph 65 of Schedule 3 will include all legal share capital, regardless of how the shares are classified for accounting purposes.

## 22 Share premium account and reserves

| | | Share premium account | Profit and loss account |
|---|---|---|---|
| | **Group** | **£m** | **£m** |
| | **At 1 January 2013** | 17.8 | 243.9 |
| FRS 23, 32 | Exchange differences | – | (5.9) |
| | Retained profit for the year | – | 82.7 |
| FRS 17, 57 | Actuarial (loss)/gain on pension scheme | – | (2.9) |
| | Movement of deferred tax relating to pension liability | – | (0.1) |
| | Dividend paid on equity shares | – | (8.0) |
| | **At 31 December 2013** | **17.8** | **309.7** |

**Company**

Sch1, 59

| | Share premium account | Profit and loss account |
|---|---|---|
| | **£m** | **£m** |
| **At 1 January 2013** | 17.8 | 42.8 |
| Retained profit for the year | – | 81.0 |
| Dividend paid on equity shares | – | (8.0) |
| **At 31 December 2013** | **17.8** | **115.8** |

Sch3, 77(2)

***Movements in reserves and provisions***

Schedule 3 requires an analysis to be given of the movements in reserves and provisions. The disclosure applies only to items included within the balance sheet liability category "provisions for other risks and charges" and does not include movements in technical provisions.

FRS 28, 11(b)

Corresponding amounts are not required to be disclosed in respect of transfers to or from reserves and provisions and the source and application of any transfers.

**Profit for the financial year**

s408

As permitted by section 408 of the Companies Act 2006, the Company's profit and loss account has not been included in these financial statements. The Company's profit for the financial year was £81.0 m (2012: £43.7m).

## 23 Reconciliation of movements in Group shareholders' funds

FRS3, 28

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| **Opening shareholders' funds** | **748.4** | 799.5 |
| Profit/(loss) for the financial year | **82.7** | (32.9) |
| Net foreign exchange differences | **(5.9)** | 4.3 |
| Actuarial (loss)/gain recognised in the pension scheme | **(2.9)** | (8.3) |
| Movement on deferred tax relating to pension asset | **(0.1)** | 0.4 |
| Dividends paid on equity shares | **(8.0)** | (14.6) |
| Net addition/(reduction) to shareholders' funds | **65.8** | (51.1) |
| **Closing shareholders' funds** | **814.2** | 748.4 |
| Included in Group shareholders' funds are aggregate net foreign exchange differences as follows: | | |
| Aggregate net foreign exchange differences included in opening shareholders' funds | **5.7** | 1.4 |
| Net foreign exchange differences for year | **(5.9)** | 4.3 |
| **Aggregate net foreign exchange differences included in closing shareholders' funds** | **(0.2)** | 5.7 |

FRS 23, 52(b)

FRS 23 requires separate disclosure of the aggregate net exchange differences recognised through the statement of total recognised gains and losses and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

FRS 3, 59

The reconciliation of movements in Group shareholders' funds may be included as a primary statement but should be shown separately from the Statement of Total Recognised Gains and Losses.

Sch3, 54(2)

## 24 Discounted claims

The claims relating to third-party liability business have been discounted as follows:

| | Discount rates | | Mean term of liabilities |
|---|---|---|---|
| Class of business | **2013** | **2012** | |
| Employers' liability | **6.0%** | 6.5% | 4.7 years (2012: 4.8) |
| Public liability | **6.0%** | 6.5% | 5.1 years (2012: 5.8) |

The period that will elapse before claims are settled is determined using a statistical analysis of historical settlement patterns.

The claims provisions before discounting are as follows:

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Total claims provisions before discounting | **2,178.6** | 2,101.3 |
| Reinsurers' share of total claims provisions before discounting | **(279.3)** | (272.3) |
| | **1,899.3** | 1,829.0 |

ABI, 113

The unwinding of the discount, included within claims incurred net of reinsurance, during the year was £22.8m (2012: £21.3m). The investment return on the assets supporting the liabilities being discounted was £25.6m (2012: £24.2m).

ABI, 111

Schedule 3 and the ABI SORP require the following disclosures to be made:

- total provision before discounting;
- categories of claims discounted; and
- methods used, rates and criteria for establishing claim settlement period.

PwC

The ABI SORP does not specify whether the total provision before discounting to be disclosed is gross or net of reinsurance. Both have been given here.

PwC

Where the level of discounting is material it may be appropriate for companies to make further disclosures of its effects on the face of the profit and loss account.

## 25 Equalisation provision

ABI, 126

As explained in accounting policy F, an equalisation provision is established in the Group financial statements. The effect of this provision is to reduce shareholders' funds by £20.2m (2012: £10.2m). The increase in the provision during the year had the effect of reducing the balance on the technical account for general business and the profit on ordinary activities before taxation by £9.4m (2012: £8.8m).

## 26 Other technical provisions

| | | 2013 | 2012 |
|---|---|---|---|
| | | £m | £m |
| ABI, 117 | Provision for unexpired risks | **17.8** | - |
| | Financial liabilities arising from investment contracts (Note 28) | **67.4** | 59.8 |
| | | **85.2** | 59.8 |

FRS 29, 25

All financial liabilities arising from investment contracts relate to certain group healthcare contracts and are carried at amortised cost. The carrying amounts and fair value are as follows:

| | Carrying amounts | | Fair values | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| | £m | £m | £m | £m |
| Investment contract liabilities | **67.4** | 59.8 | **65.2** | 58.1 |

The fair value of investment contract liabilities at amortised cost is based on a discounted cash flow valuation technique. The discount rate is determined by current market assessment of the time value of money and is risk specific to the liability. There will be no significant difference between the carrying amount and the maturity amount at the maturity date.

## 27 Provisions for other risks and charges – Group

FRS 12, 3(c)

**FRS 12 'Provisions, contingent liabilities and contingent assets'**

PwC
FRS 12, 3(d)

Insurance companies are exempt from the requirements of FRS 12 "Provisions, contingent liabilities and contingent assets" in respect of items arising from contracts with policyholders. As a result, an insurer's technical provisions will not be within the scope of FRS 12. In addition, we interpret this exemption to extend to balances in respect of the outwards reinsurance of contracts with policyholders and so, in particular, the reinsurers' share of technical provisions will not be within the scope of FRS 12. However, the requirements of FRS 12 will, in general, apply to balances shown under the heading "Provision for other risks and charges" except where they are covered by a more specific requirement of an FRS or an SSAP.

FRS 12, 14
FRS 12, 36

FRS 12 states provision should be made when and only when a company has a legal or constructive obligation at the balance sheet date, resulting from a past event, which it is probable will lead to a transfer of economic benefits which can be reliably estimated. The amount that should be provided should represent the best estimate of the expenditure required.

FRS 12, 89 & 90

In addition to an analysis of movements in provisions during the year, narrative disclosure should be given, for each class of provision, of the nature of the obligation giving rise to the provision and the expected timing of the transfer of economic benefit. Disclosure should also be made of uncertainties surrounding the quantum and timing of the transfer.

Refer also to the text box at the start of the Accounting Policies section, which discusses the ABI SORP guidance on the application of FRS 12 to insurers in the context of FRS 18.

Sch3, 77

| | Deferred tax | Termination provision | Other | Total |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **At 1 January 2013** | 28.2 | 19.8 | 4.5 | 52.5 |
| Profit and loss account charge | 23.1 | – | 2.3 | 25.4 |
| Utilised in year: | | | | |
| - operating profit | - | (5.0) | (1.9) | (6.9) |
| - loss on termination | – | (7.5) | – | (7.5) |
| **At 31 December 2013** | **51.3** | **7.3** | **4.9** | **63.5** |

### *(a) Termination provision*

ABI, 138
FRS 12, 90

The termination provision represents provision for the termination and costs of running-off the book of aviation business which the Group ceased writing on 31 December 2007. The provision has been set based on the directors' estimate of the likely costs of running-off the business. It is estimated that all of the costs associated with running-off the business will be incurred by 31 December 2015. The gross provision of £8.8m (2012: £23.9m) has been reduced by offsetting expected future investment return of £1.5m (2012: £4.1m).

FRS 3, 18

On a termination of a business segment, provision should be made covering only the direct costs of sale or termination and any operating losses up to the date of termination.

FRS 3, 18

In subsequent years the profit and loss account should show the results of discontinued operations under each of the statutory accounts format headings, with the utilisation of the provisions analysed between operating loss and the loss on the sale or termination, and disclosed on the face of the profit and loss account.

ABI, 137 & 138

Provision should be made for the full cost of running-off any material category of business which the company has ceased to write. Full provision should be made in the accounting period in which the decision is made to cease writing new business. Future investment income should be taken into account in setting the provision to the extent it is not already recognised in setting the technical provisions. The provision before investment income and the income set-off must be disclosed.

ABI, 139

There should be no change in the principles used to set claims provisions for such business.

PwC

For insurance business in run-off, the implication of the requirement of FRS 3 is that the provision should be set up to cover both the costs of termination (e.g., redundancy of underwriters) and the ongoing costs of running-off the book of business (after taking account of future investment income and to the extent not already covered by claims provisions). The release of the provision will then be made against both the relevant headings in the profit and loss account, with respect to the ongoing costs of run-off, and against the "super exceptional" costs of termination.

### *(b) Deferred tax*

FRS 19, 61(a)

The provision for deferred taxation provided in the financial statements is as follows:

| | Group | |
|---|---|---|
| | 2013 | 2012 |
| | £m | £m |
| Unrealised gains on investments | **65.8** | 44.0 |
| Accelerated capital allowances | **0.7** | 0.5 |
| Provisions | **(3.7)** | (7.5) |
| Other short-term timing differences | **(11.5)** | (8.8) |
| **Total deferred tax** | **51.3** | 28.2 |

FRS 19, 64(d)

A potential deferred tax asset of £11.16m (2012: £11.76m) in respect of certain unutilised tax losses has not been recognised as there is insufficient evidence that it will be recoverable. This asset would be recovered should sufficient taxable profits be generated in future which would be eligible for relief against the unutilised tax losses.

FRS 19

FRS 19 "Deferred tax" requires full provision to be made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation.

The general principle underlying the requirements is that deferred tax should be recognised as a liability or asset if the transactions or events that give the entity an obligation to pay more tax in future or a right to pay less tax in future have occurred by the balance sheet date. The FRS:

(a) requires deferred tax to be recognised on most types of timing difference, including those attributable to:
- accelerated capital allowances;
- accruals for pension costs and other post-retirement benefits that will be deductible for tax purposes only when paid;
- elimination of unrealised intragroup profits on consolidation;
- unrelieved tax losses; and
- other sources of short-term timing differences.

(b) prohibits the recognition of deferred tax on timing differences arising when:
- a fixed asset is revalued without there being any commitment to sell the asset;
- the gain on sale of an asset is rolled over into replacement assets; and
- the remittance of a subsidiary, associate or joint venture's earnings would cause tax to be payable, but no commitment has been made to the remittance of the earnings.

(c) requires deferred tax assets to be recognised to the extent that it is regarded as more likely than not that they will be recovered.

As an exception to the general requirement not to recognise deferred tax on revaluation gains and losses, the FRS requires deferred tax to be recognised when assets are continuously revalued to fair value, with changes in fair value being recognised in the profit and loss account.

The FRS permits but does not require entities to adopt a policy of discounting deferred tax assets and liabilities.

The FRS includes other requirements regarding the measurement and presentation of deferred tax assets and liabilities. These include requirements for the deferred tax to be:

- measured using tax rates that have been enacted or substantively enacted; and
- presented separately on the face of the balance sheet if the amounts are so material that, in the absence of such disclosure, readers may misinterpret the financial statements.

The FRS requires information to be disclosed about factors affecting current and future tax charges. A key element of this is a requirement to disclose a reconciliation of the current tax charge for the period to the charge that would arise if the profits reported in the financial statements were charged at a standard rate of tax. FRS 19 also amends FRS 7 "Fair Values in Acquisition Accounting". The amendment requires deferred tax recognised in a fair-value exercise to be measured in accordance with the requirements of the FRS. Thus, deferred tax would not be recognised on an adjustment to recognise a non-monetary asset acquired with the business at its fair value on acquisition.

### *(c) Other provisions*

Other provisions primarily relate to levies and fees anticipated to be raised during the coming year for which a present obligation exists at the balance sheet date.

ABI, 222
ABI, 223

Provisions for premium levies should be made in accordance with FRS 12. Where it is unclear whether there is a present obligation, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date. The ABI SORP clarifies that for this purpose the 'past event' is the recognition in the financial statements of the premium by reference to which the levy is calculated.

ABI, 223

Where it has been determined that there is a present obligation at the balance sheet date, then the declaration of the levy will constitute sufficient evidence on which to base a provision. In addition, consideration may need to be given to any statement of intent by a guarantee fund to raise further levies, or any consistent trend in the amount and timing of levies in previous periods.

ABI, 223

Where the conditions for establishing a provision are not satisfied, consideration should be given to whether disclosure of a contingent liability is required.

## 28 Financial liabilities

Sch3, 79

| | Group | | Company | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| | £m | £m | £m | £m |
| **Debenture and other loans, repayable otherwise than by instalments (unsecured), at amortised cost** (Sch3, 79(1)&(2)) | | | | |
| In less than five years: | | | | |
| 6.25% guaranteed bonds 2015 | **25.0** | 25.0 | **–** | – |
| In more than five years: | | | | |
| 7.375% guaranteed bonds 2020 | **10.0** | 10.0 | **–** | – |
| 60.0m 8% cumulative preference shares of £1 each | **60.0** | 60.0 | **60.0** | 60.0 |
| | **95.0** | 95.0 | **60.0** | 60.0 |
| **Amounts owed to credit institutions, at amortised cost** | | | | |
| Bank loans – secured (Sch3, 79(4)) | **38.4** | 70.2 | **13.5** | 46.9 |
| – unsecured | **30.3** | 3.1 | **30.3** | 3.1 |
| Bank overdrafts | **15.1** | 4.1 | **15.1** | 4.1 |
| | **83.8** | 77.4 | **58.9** | 54.1 |
| **Total borrowings – financial liabilities at amortised cost** | **178.8** | 172.4 | **118.9** | 114.1 |
| **Other financial liabilities, at amortised cost** | | | | |
| Investment contract liabilities (included in Other technical provisions – see Note 26) | **67.4** | 59.8 | **-** | - |
| Deposits received from reinsurers | **5.8** | 6.2 | **-** | - |
| Creditors | **233.8** | 211.4 | **7.3** | 25.8 |
| **Total financial liabilities, at amortised cost** (FRS 29, 8(f)) | **485.8** | 449.8 | **126.2** | 139.9 |

The bank loans at 31 December 2013 and 2012 are repayable within one year or on demand and are chargeable at various interest rates from 0.75% to 2.0% above LIBOR.

Sch3, 79(4) The secured loans are secured as a first charge over the freehold properties of the companies concerned.

FRS 29, 29(a) The carrying amount of amounts owed to credit institutions and creditors approximate their fair value.

FRS 29, 25 The carrying amounts and fair value of the non-current borrowings are as follows:

| | Carrying amounts | | Fair values | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| | £m | £m | £m | £m |
| **Debenture and other loans** | | | | |
| Guaranteed bonds 2015 and 2020 | **35.0** | 35.0 | **31.6** | 31.1 |
| Redeemable preference shares | **60.0** | 60.0 | **56.7** | 56.9 |
| | **95.0** | 95.0 | **88.3** | 88.0 |

The aggregate fair values of borrowings are determined using a discounted cash flow model, based on a current yield curve appropriate for the remaining term to maturity. The discount rate used in the valuation technique is based on the borrowing rate of 5.5% (2012: 5.2%).

The carrying amounts and fair value of investment contract liabilities are shown in Note 26.

FRS 29, 31, 34(c)

The carrying amounts of the Group's borrowings are denominated in the following currencies:

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| UK Pounds | 175.1 | 169.9 |
| US Dollars | 3.7 | 2.5 |
| | 178.8 | 172.4 |

Sch3, 79

The specific disclosure requirements of Schedule 3 in respect of each category shown under creditors in a company's balance sheet are as follows:

(i) the aggregate amount of debts which are payable or repayable otherwise than by instalments and fall due for payment or repayment after five years, together with debts which are payable or repayable by instalments, any of which fall due for payment after five years;
(ii) the terms of payment or repayment and the rate of any interest payable in respect of debts falling within (i) above. (Where the directors are of the opinion that the number of debts would result in this disclosure being of excessive length, it is permissible to give a general indication of the terms of payment or repayment and the rates of any interest payable on the debts.);
(iii) the aggregate amount of any debts in respect of which security has been given by the company and an indication of the nature of such securities so given; and
(iv) amounts owed by group undertaking or undertakings in which the company has a participating interest should be shown separately as sub-items.

Sch3 BS (29)

In addition, the amount of any convertible loans included within debenture loans are required to be disclosed.

FRS 29 requires the carrying amounts of the following categories of financial liabilities, as defined in FRS 26, to be disclosed either on the face of the balance sheet or in the notes:

FRS 29, 8

- financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those classified as held for trading; and
- financial liabilities measured at amortised cost.

Proforma-Gen Limited carries all financial liabilities at amortised cost.

FRS 29, 10

Where an entity has designated a financial liability as at fair value through profit or loss under FRS 26, it is required to disclose the following, together with the methods used:

(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:
    (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (including benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit- linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.); or
    (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability; and
(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

FRS 29, 11(b)

If the entity believes that the disclosure it has given to comply with the above requirements does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant should be disclosed.

FRS 29, 14

FRS 29 requires disclosure of the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, together with the related terms and conditions.

For loans payable at the reporting date, the following information should be given:

FRS 29, 18

- details of any defaults during the period of principal plus interest, sinking fund or redemption terms on those loans;
- carrying amount of any loans in default at the balance sheet date; and
- whether the default was remedied or terms renegotiated before the financial statements were authorised for issue.

FRS 29, 19

The above disclosures also relate to other breaches of loan agreements which permitted the lender to demand accelerated repayment (unless remedied or renegotiated before the year-end).

## 29 Other creditors including tax and social security

| | | Group | | Company | |
|---|---|---|---|---|---|
| | | **2013** | 2012 | **2013** | 2012 |
| | | **£m** | £m | **£m** | £m |
| SSAP 8, 14 | Corporation tax | **31.1** | – | **1.8** | – |
| | Other creditors | **24.8** | 11.1 | **1.7** | 8.1 |
| | | **55.9** | 11.1 | **3.5** | 8.1 |

FRS 1, 12

## 30 Reconciliation of profit before tax to net cash inflow from operating activities

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Continuing** | **Discontinued** | **Total** | **Continuing** | **Discontinued** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| **Profit/(Loss) before tax and minority interests** | **145.0** | **0.6** | **145.6** | 4.0 | (57.0) | (53.0) |
| (Increase)/Decrease in debtors prepayments and accrued income | **(65.3)** | **5.9** | **(59.4)** | (29.8) | (2.4) | (32.2) |
| (Decrease)/Increase in creditors accruals and deferred income | **(3.9)** | **(1.7)** | **(5.6)** | 35.0 | 2.4 | 37.4 |
| Share of associate's results | **(5.5)** | **–** | **(5.5)** | (9.5) | – | (9.5) |
| Increase/(Decrease) in net Technical provisions | **128.1** | **(53.2)** | **74.9** | 80.9 | (2.0) | 78.9 |
| (Decrease)/Increase in deposits received from reinsurers | **–** | **(0.4)** | **(0.4)** | 1.8 | (1.1) | 0.7 |
| Decrease/(Increase) in deposits with ceding undertakings | **0.9** | **–** | **0.9** | – | – | – |
| Realised and unrealised investment (gains)/losses | **(116.2)** | **(1.1)** | **(117.3)** | 22.3 | 0.6 | 22.9 |
| Loss/(Profit) on disposals of fixed assets | **1.7** | **–** | **1.7** | (4.0) | 2.8 | (1.2) |
| Interest expense | **13.5** | **–** | **13.5** | 13.0 | – | 13.0 |
| Depreciation of tangible fixed assets | **13.1** | **–** | **13.1** | 12.2 | – | 12.2 |
| Amortisation of goodwill | **2.4** | **–** | **2.4** | - | - | - |
| Difference between pension charge and cash contributions | **(0.9)** | **–** | **(0.9)** | (4.4) | – | (4.4) |
| (Decrease)/Increase in provision for loss on discontinued operations | **–** | **(12.5)** | **(12.5)** | – | 19.8 | 19.8 |
| **Net cash inflow/(outflow) from operating activities** | **112.9** | **(62.4)** | **50.5** | 121.5 | (36.9) | 84.6 |

FRS 1, 35

The reconciliation of operating profit to net cash flows from operating activities should normally take profit or loss on ordinary activities before tax as its starting point.

FRS 1, 56

It is not mandatory to analyse cash flows between continuing and discontinued operatives. However, such analysis is encouraged by FRS 1, "Cash Flow Statements" and has been given here.

FRS 1, 43

## 31 Cash flows on purchase of subsidiary undertaking

| | 2013 |
|---|---|
| | £m |
| Net cash acquired with subsidiary undertaking | **0.3** |
| Portfolio investments less financing acquired with subsidiary undertaking | **115.7** |
| Other net liabilities | **(65.8)** |
| | **50.2** |
| Goodwill | **29.7** |
| Settled by: | |
| Payment of cash | **79.9** |

The subsidiary undertaking acquired during the year contributed £2.7m to the Group's net operating cash flows, and utilised £0.2m for capital expenditure.

FRS 1, 45

Material effects on amounts reported under each of the standard headings reflecting the cash flows of subsidiaries acquired or disposed must be disclosed as far as practicable.

## 32 Portfolio investments

### *(a) Movement in portfolio investments net financing*

| | 2013 |
|---|---|
| | £m |
| Decrease in cash holdings | **(15.9)** |
| Cash outflow on portfolio investments | **(39.6)** |
| Increase in borrowings | **(6.4)** |
| **Movement arising from cash flows** | **(61.9)** |
| Acquired with subsidiary | **115.7** |
| Changes in market value and currencies | **92.0** |
| **Total movement in portfolio investments, net of financing** | **145.8** |
| Portfolio investments, net of financing at 1 January 2013 | **2,474.0** |
| **Portfolio investments, net of financing at 31 December 2013** | **2,619.8** |

### *(b) Cash flows invested in portfolio investments*

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| Purchase of shares and other variable-yield securities | **99.6** | 57.5 |
| Purchase of debt securities and other fixed-income securities | **51.3** | 71.9 |
| Purchase of land and buildings | **5.9** | 11.7 |
| Sale of shares and other variable-yield securities | **(184.3)** | (75.0) |
| Sale of debt securities and other fixed-income securities | **(62.0)** | (54.5) |
| Sale of land and buildings | **(2.5)** | – |
| Net increase in deposits with credit institutions | **52.4** | 12.9 |
| Net cash (outflow)/inflow on portfolio investments | **(39.6)** | 24.5 |

FRS 1, 48

Comparative figures are not required for the note to the statement that analyses changes in the balance sheet amounts making up portfolio investments less financing or the note of the material effects of acquisitions and disposals of subsidiary undertakings.

### *(c) Movement in cash, portfolio investments and financing*

FRS1, 35

| | At 1 Jan 2013 | Cash flow | Acquired with subsidiary | Changes to market values and currencies | Other changes | At 31 Dec 2013 |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| Cash at bank and in hand | 94.0 | (15.9) | – | – | – | **78.1** |
| Shares and other variable-yield securities | 1,125.5 | (84.7) | 53.8 | 85.5 | – | **1,180.1** |
| Debt securities and other fixed-income securities | 982.4 | (10.7) | 56.4 | 0.6 | – | **1,028.7** |
| Land and buildings | 115.6 | 3.4 | 5.5 | 5.9 | – | **130.4** |
| Deposits with credit institutions | 328.9 | 52.4 | – | – | – | **381.3** |
| Loans due within one year | (23.3) | (1.7) | – | – | (10.0) | **(35.0)** |
| Loans due later than one year | (89.1) | (4.7) | – | – | 10.0 | **(83.8)** |
| Preference shares | (60.0) | – | – | – | – | **(60.0)** |
| **Total** | **2,474.0** | **(61.9)** | **115.7** | **92.0** | **–** | **2,619.8** |

## 33 Pension and similar obligations

FRS 17, 77(a)

The Group operates a funded scheme of the defined benefit type with assets held in separate trustee-administered funds to meet long-term pension liabilities to past and present employees. . The scheme provides retirement benefits on the basis of members' final salary. The trustees of the fund are required to act in the best interest of the fund's beneficiaries. The appointment of trustees to the fund is determined by the scheme's trust documentation. The Group has a policy that one-third of all trustees should be nominated by members of the fund, including at least one member by current pensioners.

In addition to its statutory duties the board of trustees have been granted the power to 'call' for additional contributions in the event of certain circumstances. The circumstances in which the trustees can exercise this power include a disposal that accounts for more than 15% of the net assets, as reported in the consolidated balance sheet or when the funding position of the scheme falls below 65% of the scheme liabilities.

An actuarial valuation of the Group pension scheme, using the projected unit basis, was carried out at 31 December 2013 by Actuary & Actuary, independent consulting actuaries.

The principal assumptions used by the actuaries were:

FRS 17, 77(m)

| | 2013 | 2012 |
|---|---|---|
| Inflation assumption | **3.6%** | 3.3% |
| Rate of increase in salaries | **3.6%** | 3.0% |
| Rate of increase in pensions in payment | **3.0%** | 4.0% |
| Discount rate | **6.0%** | 5.5% |
| Mortality assumptions: | | |
| Longevity at age 65 for current pensioners | | |
| - Men | 22.5 years | 22.1 years |
| - Women | 24.8 years | 24.3 years |

| | | |
|---|---|---|
| Longevity at age 65 for future pensioners | | |
| - Men | 24.8 years | 24.3 years |
| - Women | 26.8 years | 26.3 years |

The assets in the scheme and the expected rates of return were:

FRS 17, 77 (e),(i) & (m)

| | Long-term rate of return expected for 2013 | Value at 31 December 2013 | Long-term rate of return expected for 2012 | Value at 31 December 2012 |
|---|---|---|---|---|
| | | £m | | £m |
| Equities | **7.9%** | **94.0** | 8.4% | 91.5 |
| Bonds | **5.4%** | **33.1** | 5.6% | 22.9 |
| Total market value of assets | | **127.1** | | 114.4 |
| Present value of scheme liabilities | | **(138.7)** | | (126.2) |
| Deficit in scheme | | **(11.6)** | | (11.8) |
| Related deferred tax asset | | **3.5** | | 3.6 |
| **Net pension liability** | | **(8.1)** | | (8.2) |

FRS 17, 77(b)

| | 2013 | 2012 |
|---|---|---|
| | £m | £m |
| **Reconciliation of present value of scheme liabilities** | | |
| At 1 January | **126.2** | 118.1 |
| Current service cost | **12.3** | 10.5 |
| Past service cost | **0.7** | 0.6 |
| Interest cost | **5.7** | 5.2 |
| Benefits paid | **(8.9)** | (10.8) |
| Net actuarial loss | **2.7** | 2.6 |
| At 31 December | **138.7** | 126.2 |

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**Sensitivity analysis of scheme liabilities**

The sensitivity of the present value of scheme liabilities to changes in the principal assumptions used is set out below:

| | Change in assumption | Impact on scheme liabilities |
|---|---|---|
| Discount rate | Increase/decrease by 1% | Increase/decrease by 9.5% |
| Rate of inflation | Increase/decrease by 1% | Increase/decrease by 4.5% |
| Rate of increase in salaries | Increase/decrease by 1% | Increase/decrease by 4.0% |
| Rate of increase in pensions in payment | Increase/decrease by 1% | Increase/decrease by 3.5% |
| Mortality | Increase by 1 year | Increase by 5.0% |

| | | 2013 | 2012 |
|---|---|---|---|
| FRS 17, 77(d) | **Reconciliation of fair value of scheme assets** | **£m** | **£m** |
| | At 1 January | **114.4** | 106.9 |
| | Expected return on scheme assets | **7.9** | 8.5 |
| | Contributions paid by employer | **14.9** | 13.5 |
| | Benefits paid | **(8.9)** | (10.8) |
| | Actuarial gains / (losses) | **(1.2)** | (3.7) |
| | At 31 December | **127.1** | 114.4 |

FRS 17, 77(j) Scheme assets do not include any of Proforma-Gen Limited's own financial instruments or any property occupied by Proforma-Gen Limited.

FRS 17, 77(k) The expected return on scheme assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date. Expected returns on equity and property investments reflect long-term real rates of return experienced in the respective markets.

FRS 17, 77(l) The actual return on scheme assets in the year was £10.5m (2012: £3.2m).

| | | 2013 | 2012 |
|---|---|---|---|
| | **Analysis of amount charged to profit (included in net operating expenses** | **£m** | **£m** |
| FRS 17, 77(f) | Current service cost | **12.3** | 10.5 |
| FRS 17. 77(f) | Past service cost | **0.7** | 0.6 |
| | Total operating charge | **13.0** | 11.1 |
| | | | |
| | **Analysis of amount credited to profit (included in other finance income)** | | |
| FRS 17, 77(f) | Expected return on pension scheme assets | **7.9** | 8.5 |
| FRS 17, 77(f) | Interest cost on pension scheme liabilities | **(5.7)** | (5.2) |
| | Net return | **2.2** | 3.3 |
| | | | |
| | **Analysis of amount recognised in statement of total recognised gains and losses** | | |
| FRS 17, 77(g) | Actual return less expected return on pension scheme assets | **2.6** | (5.3) |
| FRS 17, 77(g) | Experience gains and losses arising on scheme liabilities | **(0.2)** | (5.1) |
| FRS 17, 77(g) | Changes in assumptions underlying the scheme liabilities | **(5.3)** | 2.1 |
| | Actuarial (loss)/gain | **(2.9)** | (8.3) |

FRS 17, 77(h) The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses is £21.4m (2012: £18.5).

FRS 17, 77(p) The full actuarial valuation at 31 December 2013 showed a small reduction in the deficit in the scheme from £11.8m at 31 December 2012 to £11.6m. No additional improvements in benefits were made in either 2013 or 2012. As a result of the deficit at 31 December 2012, it was agreed with the actuaries and trustees of the pension scheme that from 1 January 2013 contributions would continue to be made to the pension scheme at a rate of 7% of pensionable salaries (2012: 7%). It has been agreed with trustees that contributions will remain at that level for the next three years. As a result, the total contributions expected to be made to the scheme by Proforma-Gen Limited in the year to 31 December 2013 is £14.9m.

FRS 17, 77(o)

| Amounts for current period and previous four periods | 2013 £m | 2012 £m | 2011 £m | 2010 £m | 2009 £m |
|---|---|---|---|---|---|
| Defined benefit obligation | (138.7) | (126.2) | (118.1) | (110.8) | (105.5) |
| Plan assets | 127.1 | 114.4 | 106.9 | 101.7 | 96.4 |
| Surplus /(Deficit) | **(11.6)** | **(11.8)** | **(11.2)** | **(9.1)** | **(9.1)** |
| Experience adjustments on plan assets | 2.6 | (5.3) | (4.8) | (5.3) | (3.9) |
| Experience adjustments on plan liabilities | (0.2) | (5.1) | (4.9) | (5.6) | (5.2) |

**Treatment of the charge for the year**

The charge/credit relating to the pension fund is taken to three separate areas in the performance statement:

ABI, 229

- current and any past service costs of a defined benefit scheme should be included under the appropriate headings in the Profit and Loss Account;

ABI, 230

- the difference between the interest costs and the expected investment return on pension fund assets should be included as appropriate in the Technical account for long-term insurance or the Non-technical account as a new line within Investment income/charges; and

ABI, 231

- the Statement of Total Recognised Gains and Losses (STRGL) should show actuarial gains/losses attributable to shareholders showing:
  - differences between the expected return on the scheme assets and the actual return;
  - the impact of experience variations on the scheme liabilities and the effect of changes in assumptions; and
  - adjustments due to limits on the amount that can be recognised as a pension fund asset in the balance sheet.

**Balance sheet**

ABI, 233

A pension asset or liability should be shown as the last item of the assets or liabilities section as appropriate. A sub-total of assets or liabilities should be disclosed immediately before the pension fund asset or liability.

ABI, 235

The methodology used for the calculation of the longer term rate of investment return on pension scheme assets should be consistent with any method used for the calculation of the longer term rate of investment return for insurance business.

**Treatment in group situations**

ABI, 236

In the case of groups, individual companies may not be able to identify their share of pension assets or liabilities. They are allowed to account for it as a defined contribution scheme but must disclose:

- the fact that the scheme is a defined benefit scheme and they are unable to identify their share of assets and liabilities, and
- any available information about the existence of the surplus or deficit in the scheme and its implications for the employer.

ABI, 237

The consolidated accounts should show the group scheme as a defined benefit scheme.

**Death-in-service and incapacity benefits**

UITF 35

Where death-in-service and incapacity benefits are provided through a defined benefit pension scheme and are

not wholly insured, the uninsured scheme liability and the cost of the accounting period should be measured using the projected unit method, in line with other retirement benefits. The valuation of uninsured benefits therefore reflects the current period's portion of the full benefits ultimately payable in respect of current members of the scheme. The cost of insured benefits is determined by the relevant insurance premiums.

UITF 48

**Replacement of RPI with CPI for retirement benefits**

Where there is a change from RPI to CPI in the inflation measure used to calculate increases in pensions, this will be a change in benefits (giving rise to a past service cost) if there is an existing obligation to pay pensions with increases based on RPI, otherwise it will be a change in financial assumption (giving rise to an actuarial gain or loss). Where there is such a change, disclosures should explain the effect of changes in the scheme liabilities.

## 34 Guarantees and financial commitments

Annual commitments in respect of non-cancellable operating leases are as follows:

SSAP 21, 56

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | **Land and buildings** | **Other** | **Land and buildings** | **Other** |
| | **£m** | **£m** | £m | £m |
| Operating leases which expire: | | | | |
| Within one year | **2.7** | **2.1** | 1.9 | – |
| Between one and five years | **7.3** | **1.1** | 8.2 | 3.2 |
| After five years | **1.7** | **–** | – | – |
| | **11.7** | **3.2** | 10.1 | 3.2 |

**Contingent assets and liabilities**

FRS 12, 3

The requirements relating to disclosure of contingent assets and liabilities are set out in FRS 12. Insurance entities are exempt from making any disclosures in respect of contingencies arising from contracts with policyholders.

FRS 12, 27 & 31

Under FRS 12 neither contingent assets nor contingent liabilities should be recognised in the balance sheet.

FRS 12, 91

Unless the possibility of any loss is remote, disclosure should be made of the nature, estimated financial effect and timing of contingent liabilities, together with details of associated uncertainties and any potential reimbursement.

FRS 12, 94

Only where the inflow of a benefit is probable should disclosure of the nature and quantum of contingent assets be given.

## 35 Inherent uncertainty

The claims provisions include amounts in respect of potential claims relating to environmental pollution. Legislative and judicial actions to date have failed to determine the basis of liability to indemnify losses. These claims are not expected to be settled for many years and there is considerable uncertainty as to the amounts at which they will be settled. The level of provision has been set on the basis of the information that is currently available, including potential outstanding loss advices, experience of development of similar claims and case law. The most significant assumptions made relate to the level of future claims, the level of future claims settlements and the legal interpretation of insurance policies. Whilst the directors consider that the gross provision for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of provision are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly.

ABI, 240

Where there is inherent uncertainty in respect of liabilities arising from insurance business, the following disclosures are required:

- a broad description of the factors giving rise to the uncertainty;
- a description of those items to which significant estimation techniques have been applied;
- a description of the estimation techniques used;
- details of the significant assumptions made and information used in forming the estimates; and
- a note of those factors to which the estimation technique is particularly sensitive.

## 36 Ultimate parent company

FRS 8, 5
Sch4, 8 & 9

The directors regard Proforma-US Inc, a company incorporated in the USA, as the immediate and ultimate parent company and ultimate controlling party. Copies of the consolidated financial statements of Proforma-US Inc can be obtained from The Secretary, Proforma-US Inc, 589 Fourth Avenue, New York 59361.

FRS 8, 3

Advantage has been taken of the exemption in FRS 8 not to disclose transactions with the ultimate parent company or any of its wholly owned subsidiaries.

**Related parties**

FRS 8, 2.5

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity').

(a) A person or a close member of that person's family is related to a reporting entity if that person:

- (i) has control or joint control over the reporting entity;
- (ii) has significant influence over the reporting entity; or
- (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
- (iii) Both entities are joint ventures of the same third party.
- (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
- (v) The entity is a retirement benefit scheme for the benefit of the employees of the reporting entity or an entity related to it
- (vi) The entity is controlled by a person who is a related party
- (vii) A person who controls the reporting entity has significant influence over the entity or is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

**Related party disclosures**

FRS 8, 6
Sch3, 90

Under FRS 8, transactions and balances with related parties must be disclosed. In addition, details of material related party transactions not concluded under normal market conditions are also required to be disclosed by virtue of Schedules 3.

FRS 8, 3
Sch3, 90
Sch6, 22 & 39

There is no requirement to disclose in consolidated financial statements balances and transactions that are eliminated on consolidation. Where the company is a wholly owned subsidiary, there is also an exemption from disclosing transactions (but not balances) with other members of the parent company's group (provided that any subsidiary undertaking which is a party to the transaction is wholly owned by a member of that group). The previous exemption from FRS 8 in respect of parent undertakings own financial statements where those are presented with consolidated financial statements of its group has been removed.

FRS 8, 20
PwC

Disclosure is only required in respect of material transactions, being transactions which might reasonably be expected to influence decisions made by the users of general purpose financial statements. However, where the party in question is a director or key manager (or a member of a director's or key manager's close family or an entity controlled by a director or key manager or a member of their close family) materiality must be considered in relation to both parties. Disclosure should be made irrespective of whether or not an arms-length price is charged.

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