

acquiring an insurance broker

Aidan Clifford clarifies the situation regarding goodwill when an insurance broker is acquired.

■ ACCA Ireland's Advisory Services has had a number of queries since the last issue of *In Practice Ireland* with regards to insurance brokers and goodwill on acquisition. This article clarifies exactly what the accounting position is when a life and pension renewals book is acquired.

purchase of a limited company insurance broker

The investment in a subsidiary company is valued in the separate financial statements at cost less impairment and disclosed as 'financial asset, investment in subsidiary' as required by the Companies Act 1986. This is the standard accounting for assets and a requirement of Irish company law.

In the subsidiary's own financial statements, it has a choice of applying FRS 25 and 26 (fair value) or adopting a cost model. It is likely to choose a cost model and therefore internally generated intangible assets are not included on the balance sheet. There are some arguments to say that renewal commissions meet the '...readily ascertainable market value of a homogeneous group...' requirement of FRS 10 and therefore GAAP would allow the renewals book to be valued on the balance sheet at fair value, but the more traditional cost approach is to exclude it from the balance sheet.

FRS 7, Fair Values in Acquisition Accounting, requires that 'when a business entity is acquired by another, all the assets and liabilities that existed in the acquired entity at the date of acquisition are recorded at fair values'. FRS 7 goes on to require 'where an intangible asset is recognised, its fair value should be based on its replacement cost, which is normally its estimated market value'.

The renewals book for an insurance broker is 'intangible' in that it has no physical form, but it

does have a market value, equal to 4.5 – 5.5 times the renewals commission. The renewals book also has a 'goodwill' value based on the value that a broker can achieve by servicing the client list and generating future income.

In terms of a consolidated balance sheet, goodwill is the difference between what you paid for the company and the fair value of the assets of the company. In the case of a life and pension broker, the price paid usually relates exclusively to the renewals book and little or nothing is paid for the residual goodwill.

purchasing the trade but not the company

FRS 7 also applied to the purchase of a trade or unincorporated business and the renewals book should be included in the acquiring company's accounts at its market value at the date of purchase. Renewals commission received from this book should be credited to the income statement but the intangible asset will be impaired as the policies run out or are cancelled and this impairment should be booked to the income statement.

In the *Financial Regulators Handbook of Prudential Requirements for Authorised Advisors and Restricted Intermediaries*, it states that 'goodwill may be included in the calculation of total assets only where the audited accounts are accompanied by an opinion from the auditor stating that the goodwill figure or a defined percentage of that figure represents the net present value of future cash flows arising from existing investment instruments. For the purpose of this note, goodwill arising on non-life insurance business cannot be included in the calculation of total assets.' See www.financialregulator.ie/data/in_car_files/Handbook_Requirement_final.pdf. This effectively recognises that renewals commission is an asset for the purposes of capital adequacy. ■

Aidan Clifford –
Advisory Services Manager, ACCA Ireland

