ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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Financial Services Act 2008

Procedural Instructions and Guidance on Financial Resources Statements ("FRS")

For Licenceholders excluding Class 1, Class 7, Class 8(1), 8(2)(b), 8(3) and Professional Officers

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CHAPTER 1 – INTRODUCTION

All Isle of Man incorporated licenceholders licensed to carry on Class 2, Class 3, Class 4, Class 5 and Class 8(2)(a) or 8(4) activity have to comply with minimum financial resources requirements (“FRR”) at all times, being those relating to share capital, net tangible assets, and liquid capital, as noted in Rule 2.30 (and Appendices 2 and 3) of the Financial Services Rule Book (“Rule Book”).

Accounting Standards

Note 1 of Appendix 3 requires the figures included in the FRS to be calculated in accordance with accounting standards generally accepted in the UK, International Financial Reporting Standards, Statement of Recommended Practice, or other internationally accepted accounting standards.

Interim Financial Resources Statements (“Interim FRS”)

Most Class 2 and Class 3 licenceholders must ***submit*** an interim FRS to the Authority (refer Rule 2.33) which must include an unconsolidated Statement of Financial Position (balance sheet); an unconsolidated Statement of Profit and Loss; and the Parts A to E Financial Resources calculations, which should demonstrate compliance with the requirements contained in Rule 2.30.

All other licenceholders to which this guidance applies have to evidence and document compliance with the FRR at least once in each quarter, no later than one month following the period to which it relates, and, if requested to do so, provide the calculations to the Authority (refer Rule 2.35). Rule 2.35 (previously rule 2.46) has been updated to require all of the applicable licenceholders to undertake their calculations in accordance with rule 2.3(4) to (6) using the Authority’s specified FRS template.

Annual Financial Resources Statements (“Annual FRS”)

All of the above licenceholders have to submit to the Authority an Annual FRS which must include an unconsolidated Statement of Financial Position (balance sheet); a detailed unconsolidated Statement of Profit and Loss; and the Parts A to E Financial Resources calculations, which should demonstrate compliance with the requirements contained in Rule 2.30. In addition, the Annual FRS must include either a statement that there are no differences between the Interim FRS and the Annual FRS or a reconciliation identifying the differences and the reasons for them. The Annual FRS must be reviewed and verified by its auditor on an annual basis (refer Rule 2.32). The FRS must be laid out in the format specified by the Authority.

FRS Template & guidance

In order to assist licenceholders with the submission of interim FRS, the monitoring of compliance with the FRR on a regular basis, and the preparation of an annual FRS for review by auditors, the Authority has published a spreadsheet template for licenceholders to use. This is available on the Compliance Support page of the Authority's website. These procedural instructions / guidance are designed to aid the completion of the FRS using this spreadsheet template.

SUBMISSION AND ENQUIRIES

Licenceholders are reminded of the importance of submitting all FRS within the prescribed timescales and of informing the Authority, in advance, of any difficulty they may have in meeting a deadline.

Incomplete, inaccurate, misleading, or late submission of a FRS is often an indication of weak management information, or poor accounting systems. It could also be an offence under section 40 of the Financial Services Act 2008. Thus, such occurrences could lead to the Authority requesting that Reporting Accountants be appointed to provide an explanation.

Enquiries regarding the completion of the FRS should initially be addressed to your relationship manager, Supervision Division at:

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CHAPTER 2 - UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

SECTION 1 - REQUIREMENTS

Items should be disclosed separately as far as possible to aid the Authority's understanding of the business. In particular, debtors, work in progress and prepaid expenses should be split out between those which are due within 90 days and those which are due after 90 days from the date of the balance sheet. Please note, for work in progress to be reported in "due within 90 days", it must be expected to be invoiced, and the debt collected, within 90 days of the date to which the FRS is being completed. This separation should help both the Authority and the licenceholder identify in a timely manner whether there are any issues in collecting debts. The reasons for such issues may be internal or external.

SECTION 2 – DETAILED INSTRUCTIONS

Assets

Item	Nature of Item	Instructions
A	Non-current (fixed) assets	
A.1	Intangible assets	Include all intangible fixed assets of the licenceholder, including goodwill.
A.2	Tangible assets	Include all premises, plant and equipment, other fixed assets for own use, other interests in realty, investments in land, premises, plant and equipment and all other fixed assets of the licenceholder which are held for its own use, including any fixed asset held by the licenceholder as lessee under a finance lease. Other interest in land which is not occupied or used in the operation of the licenceholder's business should also be reported here. Appendix 3 note 1 of the Rule Book states: "A licenceholder may include freehold and leasehold land and buildings at a valuation taken as its open market value on an existing use basis, if it has been valued by a qualified surveyor or valuer within the preceding 18 months, or in other cases its net book value. The Authority may require evidence of the valuation or request that a valuation be carried out at the licenceholder's expense".

Item	Nature of Item	Instructions
A.3	Investments in group and related companies	Include investments in group, subsidiary and associated companies. Such companies include: a) The licenceholder's parent and ultimate parent; b) All subsidiaries of the parent / ultimate parent; c) All companies with whom the licenceholder has entered into a joint venture, together with the joint venture itself and any subsidiaries of it; d) All companies where the licenceholder is a significant shareholder and holds over 20% of that company's share capital; and e) All companies where the licenceholder exercises management control. Further information on group, subsidiaries and associated companies is provided in ***Chapter 9***
A.4	Other fixed asset investments	Any holdings that are not disclosed in A.3, B.1.1 or B.3 (e.g. longer term investments).
	SUBTOTAL	**Total for "A: Non Current (Fixed) Assets", calculated by the spreadsheet as the sum of A.1 to A.4.**
B	Current Assets	
B.1	Stocks, debtors and prepayments	
B.1.1	Stocks of investments	Report any investments held that are not classified as investments in section B.3. NOTE: it would be highly unusual to report an item in B.1.1. Items included here must be realisable at the value stated within 3 months of the reporting date.
B.1.2	Other stocks and inventories	Report other stocks / inventories not classified as stocks of investments in B.1.1 (e.g. shelf companies). Items included here must be realisable at the value stated within 3 months of the reporting date.
B.1.3	Debtors and accrued income < 90 days	Report all non-related party debtors (receivables), loans and accrued income that are expected to be realised within 90 days of the reporting date. For this purpose it is recognised that licenceholders may have to make certain assumptions and estimates on the likelihood of realising such debtors within the next 90 days. However, any debtors which have been ***overdue*** for more than 90 days at the reporting date ***must*** be reported under B.1.4. Expenses recoverable from funds, for example initial set up costs which are being amortised, should not be reported here but under B.1.4.

Item	Nature of Item	Instructions
B.1.4	Debtors and accrued income > 90 days	Debtors which are more than 90 days ***overdue*** at the reporting date ***must*** be reported here (i.e. treated as illiquid). Also include any other non-group debtors (receivables), loans and accrued income not reported under B.1.3.
B.1.5	Work in progress < 90 days	Only report WIP that is expected to be invoiced, and the debt collected, within 90 days of the reporting date. The Authority recognises that the WIP amount may fluctuate from quarter to quarter due to the licenceholder's position in their billing cycle but the licenceholder should be able to clearly demonstrate that the WIP amounts included here can be invoiced and collected within 90 days. The Authority may request further information where WIP is significant.
B.1.6	Work in progress > 90 days	WIP not expected to be invoiced, and the debt collected, within 90 days of the reporting date must be reported here (i.e. treated as illiquid).
B.1.7	Prepaid expenses < 90 days	Report prepaid expenses to the extent that the period of prepayment does not exceed 90 days. This allows a portion of prepayment to be treated as liquid to match against expenses within the Expenditure Requirement.
B.1.8	Prepaid expenses > 90 days	Report all prepaid expenses not included in B.1.7. Any prepayment relating to a period after 90 days must be reported here.
B.1.9	Other non-group current assets	Report any other non-group current assets that are not included in lines B.1.1 to B.1.8, B.2, B.3 or B.4.
	SUBTOTAL	**Total for "B.1: Stocks, debtors and prepayments", calculated by the spreadsheet as the sum of B.1.1 to B.1.9.**

Item	Nature of Item	Instructions
B.2	Amounts due from related parties / group	
B.2.1	Amounts due from related parties – treated as "liquid"	All amounts due from related parties are considered to be illiquid and must be disallowed unless: a) they have a fixed repayment term of 3 months or less; or b) they arise in the normal course of business and are settled at least every 60 days. *Note that amounts due from related parties cannot be netted off against amounts due to related parties unless there is a legally enforceable netting agreement in place,* ***and*** *with the prior written consent of the Authority.*
B.2.2	Other amounts due from related parties / group	Any amounts due from related parties / group not included in B.2.1 above or treated as a non-current asset and disclosed in A.3. Directors' loans should be included here regardless of the repayment terms, unless it can be proven to the Authority that the loan can be repaid within 3 months (where it can be reported under B.2.1). Include amounts where there is no fixed date for repayment and longer term amounts.
	SUBTOTAL	**Total for "B.2: Amounts due from related parties / group", calculated by the spreadsheet as the sum of B.2.1 to B.2.2.**
B.3	Investments (note – these figures will be adjusted in table 1)	
B.3.1	Certificates of Deposit	Report the book value of holdings of Certificates of Deposit.
B.3.2	UK Treasury Bills	Report the book value of holdings of UK Treasury Bills.
B.3.3	Quoted fixed rate securities	Report the book value of holdings of quoted fixed rate securities.
B.3.4	Quoted floating rate and index linked securities	Report the book value of holdings of quoted floating rate and index linked securities.
B.3.5	Units in CIS authorised or recognised in IOM or UK	Report the book value of holdings of units in collective investment schemes (CIS) authorised or recognised in the IOM or UK.

Item	Nature of Item	Instructions
B.3.6	Designated stocks	Report the book value of designated stocks held.
B.3.7	Investments on recognised exchange not covered above and ICIS units	Report the book value of investments on a recognised exchange (as defined in the Rule Book) not covered elsewhere and units in international collective investment schemes (ICIS). Do not report investments in EIFs, PIFs, SFs, QFs or exempt ICIS (report these under B.3.8).
B.3.8	Other current asset investments	Report other holdings of current asset investments not reported under B.3.1 to B.3.7 (e.g. private investments which are not group related).
	SUBTOTAL	**Total for "B.3: Investments", calculated by the spreadsheet as the sum of B.3.1 to B.3.8.**
B.4	Cash at bank	
B.4.1	Term deposits > 90 days to maturity	Report here amounts held with banks on fixed or term deposit where the ***residual*** period (*time remaining until funds are to be repaid or are accessible*) to maturity is greater than 90 days from the reporting date. If the terms of the contract are such that the ***licenceholder*** has the right to break the deposit and access the funds (or portion of funds) within 90 days (with or without penalty) then the amount that can be accessed can be treated as liquid and reported in B.4.2.
B.4.2	All other cash	Report all cash that does not meet the definition contained in B.4.1.
	SUBTOTAL	Total for "B.4: Cash at bank", calculated by the spreadsheet as the sum of B.4.1 to B.4.2.
C	**Total Assets**	**Calculated by the spreadsheet as the sum of subtotals A, B.1, B.2, B.3 and B.4. This should equal line G: total liabilities and equity.**

Liabilities

Item	Nature of Item	Instructions
D	Current Liabilities (due within 1 year)	
D.1	(Trade) creditors < 1 year (excluding related parties)	Report non related party trade creditors (normal course of business) due within 1 year.
D.2	Non-refundable deferred income	Report here income received from clients (e.g. in the form of annual fees billed in advance) which is **non-refundable** under the terms of the contract. The terms of business with the client must state that the fees are non-refundable in order for the deferred income to be included here.
D.3	Bank loans, overdrafts and lease obligations < 1 year	Report loans and overdrafts due to banks and credit institutions due and repayable within 1 year. Report lease obligations due and repayable within 1 year.
D.4	Amounts due to related parties < 1 year	Report all amounts due to related parties due within 1 year. Further information on related parties is provided in ***Chapter 9***.
D.5	Tax obligations < 1 year	Report amounts due to tax authorities that are due to be settled within the next year (including VAT). Also refer to ***chapter 9*** for netting.
D.6	Other creditors < 1 year (including provisions)	Report all other liabilities due within 1 year including any provisions made, excluding tax obligations reported under D.5 (e.g. legal etc).
	SUBTOTAL	**Total for "D: current liabilities" calculated by the spreadsheet, being the sum of D.1 to D.6.**
E	Non-current liabilities (due after 1 year)	
E.1	(Trade) creditors > 1 year (excluding related parties)	Report non group trade creditors (normal course of business) due after 1 year.
E.2	Bank loans, overdrafts and lease obligations > 1 year	Report loans and overdrafts due to banks and credit institutions due and repayable after 1 year. Report lease obligations due and repayable after 1 year.
E.3	Qualifying subordinated loans	Report here any loans to the licenceholder that have been agreed in writing with the Authority as being qualifying subordinated loans. This means the loan should be in the same form as the model

Item	Nature of Item	Instructions
		issued by the Authority and it is signed by the authorised signatories of all parties. Refer to the Authority's guidance on subordinated loans for full details. Refer to Appendix 3 note 4 of the Rule Book for the qualification criteria. Extract: *"A loan to a licenceholder may be treated as a qualifying subordinated loan for the purposes of this rule provided that —* *(a) it is in the same form as the model issued by the Authority and it is signed by authorised signatories of all of the parties; and* *(b) the licenceholder's net tangible assets are in excess of its minimum share capital requirement.* *For the purpose of this calculation, only the amount of the loan actually advanced and outstanding may be counted as a qualifying subordinated loan. ..."* Regarding part (b) above, the licenceholder's net tangible assets figure is taken to be the figure prior to adding in the subordinated loan in the calculation (Part A of the FRR).
E.4	Amounts due to related parties > 1 year	Report all amounts due to related parties due after 1 year. Further information on related parties is provided in ***Chapter 9***.
E.5	Tax obligations > 1 year	Report amounts due to tax authorities that are due to be settled in more than one year's time (including deferred tax). Also refer to ***chapter 9*** for netting.
E.6	Other creditors > 1 year (including provisions)	Report all other liabilities due after 1 year including any provisions made, excluding tax obligations reported under E.5 (e.g. legal etc).
	SUBTOTAL	**Total for "E: non current liabilities" calculated by the spreadsheet, being the sum of E.1 to E.6.**
F	Capital and reserves	
F.1	Issued and paid share capital	Report the nominal value of the allotted, called up and fully paid share capital. This should be recorded net of any of its own shares that a licenceholder holds. "Fully paid" means the proceeds of the issue have been received by the licenceholder and are available to absorb losses.
F.2	Share premium account	Report share premium relating to F.1 above.

Item	Nature of Item	Instructions
F.3	Profit and loss reserve	Report the profit and loss account reserve as at the reporting date (i.e. inclusive of year to date unaudited profit / loss and adjusted for any dividends paid).
F.4	Revaluation reserve	Report any amount carried on a revaluation reserve in accordance with normal accounting practice.
F.5	Other reserves	Report any other reserve amounts not included elsewhere in section F.
	SUBTOTAL	**Total for "F: capital and reserves" calculated by the spreadsheet, being the sum of F.1 to F.5.**
G	**Total Liabilities and Equity**	**Calculated by the spreadsheet, being the sum of subtotals D, E and F. This should equal line C: total assets.**

CHAPTER 3 - UNCONSOLIDATED CUMULATIVE STATEMENT OF PROFIT AND LOSS

SECTION 1 – REQUIREMENTS

The profit and loss account (income statement) should detail a licenceholder's income and expenditure for the year-to-date in question, **i.e. it should be cumulative**.

Items should be disclosed separately as far as possible to aid the Authority's understanding of the business. In particular, income and expenses should not be offset.

SECTION 2 – DETAILED INSTRUCTIONS

Item	Nature of Item	Instructions
A	Income	
A.1	Investment management fees (Class 2)	All fees/ commissions received/ receivable by the licenceholder for portfolio management services, (both for discretionary and non-discretionary portfolios). Include only fees/ commissions agreed with the customer for the management of portfolios.
A.2	Trust and company administration fees (Class 4 & Class 5)	All fees received / receivable for administering companies on behalf of clients/trusts, including those charged for the provision of registered office, directors, company secretary, etc.
A.3	Trustee/ Custodian fees (Class 2 & Class 3)	All fees received / receivable for acting as a Class 2 Custodian or Class 3 Trustee, Fiduciary Custodian or Custodian to a Collective Investment Scheme.
A.4	Fund management / administration fees (Class 3)	All fees received / receivable for acting in any role in relation to the management or administration of a fund.

Item	Nature of Item	Instructions
A.5	Investment dealing profits and commissions (Class 2)	All commissions and profits received/ earned in investment transactions with, or on behalf of, clients. Include commission/profits from investment dealing transactions undertaken by the licenceholder where it acts as principal but buys/sells on a matched (or virtually matched) basis to clients. (For example, where the licenceholder purchases a block of shares/investments from a broker and then sells these on to its own investment clients).
A.6	Other commission income	Income from commissions not included in A.1 or A.5.
A.7	Interest receivable	Include interest actually received and interest receivable that has accrued but has not yet been received. Amounts accrued should be based on the latest date to which these calculations were made; thus for a licenceholder which accrues profits on a daily basis, accruals should include amounts up to and including the reporting date. Also include under this heading income accrued in respect of the amortisation of discounts (and premiums) on the purchase of fixed maturity investments (e.g. Treasury Bills). Please refer to ***chapter 9*** regarding ‘netting off’.
A.8	Other income	All other income not included elsewhere. Include income from unregulated activities and gains on foreign exchange transactions.

Item	Nature of Item	Instructions
	SUBTOTAL	**Calculated by the spreadsheet, being the sum of A.1 to A.8.**
B	Cost of Sales	
B.1	Commissions paid to employees / related companies	Commission paid to employees and related companies but only where this is directly attributable to commission earned by the licenceholder. This also includes fees paid / payable to another regulated company in the group which provides client related services to the licenceholder under a formal agreement, where those fees are reasonable and directly attributable to the fees earned by the licenceholder. The Authority will request further information where it is not clear from the financial statements what the cost of sales relate to.
B.2	Other	Any other costs and commissions payable directly related to income, for example cost of investments sold, or commission earned by the licenceholder. Examples of what can be reported here includes (1) commissions paid to third parties where this is based on a % of earned commission or other income by the licenceholder and included in turnover; and, (2) fees, brokerage and other charges paid to clearing houses, exchanges, approved exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions. The Authority will request further information where it is not clear from the financial statements what the cost of sales relate to.
	SUBTOTAL	**Calculated by the spreadsheet, being the sum of B.1 to B.2.**
C	Expenses	
C.1	Operating Expenses	

Item	Nature of Item	Instructions
C.1.1	Staff Costs	Include salary costs, employer's social security contributions, bonuses, the employer's contribution to any pension scheme and the costs of staff benefits paid on a per capita basis such as private medical insurance, staff travel, training concessions etc. General staff benefits, such as subsidised restaurants, would fall outside this category and be included in line C.1.6.
C.1.2	Occupancy	Include rates, rent, buildings' insurance, lighting, heating, maintenance costs, cleaning and depreciation.
C.1.3	Audit and Legal fees	Include all Audit and Legal fees.
C.1.4	Directors Remuneration	Include all costs relating to both executive and non-executive directors (e.g. directors' salaries and fees).
C.1.5	Group Management / Administration Charge	Include in this heading general management charges paid to the Parent or Group that are not specifically allocated under any other heading.
C.1.6	Other	Any other operating expenses not separately classified in C.1.1 to C.1.5 above. Include losses on foreign exchange transactions arising from operating activities.
	SUBTOTAL	**Calculated by the spreadsheet as the sum of items C.1.1 to C.1.6.**
C.2	Other Expenses	
C.2.1	Interest payable	Include interest actually paid and interest payable that has accrued but has not yet been paid. Accruals should include amounts up to and including the reporting date. Also include under this heading interest payable on loans. Please refer to ***Chapter 9*** regarding 'netting off'.
C.2.2	Specific / collective impairment charge	Enter here the net charge for specific and general bad debt provisions. A credit should be entered as a "negative" figure.

Item	Nature of Item	Instructions
C.2.3	Other expenses	Any other non-operating expenses not separately shown in C.2.1 and C.2.2. Loss on revaluation of fixed assets may be included here.
	SUBTOTAL	**Calculated by the spreadsheet as the sum of items C.2.1, C.2.2 and C.2.3.**
D	**Profit / (Loss) before tax, appropriations and extraordinary items**	**Calculated by the spreadsheet as subtotal A less subtotal B less subtotal C.1 less subtotal C.2.**
E	Extraordinary/ exceptional items	Extraordinary/exceptional items should be reported net of attributable taxation. Enter net extraordinary income as a negative figure, and net extraordinary costs as a positive figure. If figures are reported here additional information should be provided to the Authority when submitting the returns.
F	Tax charge / (credit)	A credit should be reported as a "negative".
G	**Profit / (loss) after tax**	**Calculated by the spreadsheet as being item D minus items E and F.**

CHAPTER 4 - CALCULATION OF NET TANGIBLE ASSETS (PART A)

SECTION 1 – OVERVIEW

A licenceholder's calculation of net tangible assets should be performed in accordance with Appendix 3 Part A of the Rule Book. The instructions in section 2 below provide additional information where necessary.

This calculation is designed to show a licenceholder's physical net asset position inclusive of any necessary support for subsidiaries (where applicable), and with the addition of certain subordinated loans provided to the licenceholder. Subordinated loans can be added back as there is an assumption that such a liability would not be repaid before other (non capital) liabilities if there were not enough assets available in the case of a dissolution / liquidation of the licenceholder.

SECTION 2 – INSTRUCTIONS

Item	Nature of Item	Instructions
A	Capital and reserves	This figure is automatically generated from sub-total F of the Statement of Financial Position. Appendix 3 note 1 of the Rule Book states: *"Capital and reserves are to be based on the reporting date calculated in accordance with accounting standards generally accepted in the UK, International Financial Reporting Standards, Statement of Recommended Practice or other internationally accepted accounting standards".* Therefore it is expected that the FRS includes accruals & prepayments and other accounting provisions. A licenceholder may include freehold and leasehold land and buildings at a valuation taken as its open market value on an existing use basis, if it has been valued by a qualified surveyor or valuer within the preceding 18 months, or in other cases its net book value. The Authority may require evidence of the valuation or request that a valuation be carried out at the licenceholder's expense.
B	Deductions	

Item	Nature of Item	Instructions
B.1	Goodwill and other intangible assets	This figure is automatically generated from line A.1 of the Statement of Financial Position.
B.2	Any accumulated losses of subsidiaries or associated companies	Please refer to Chapter 10, section 7 for examples of how to calculate the figure in this section.
	SUBTOTAL	Total deductions calculated automatically, being the sum of B.1 to B.4.
C.1	Qualifying subordinated loans	This figure is automatically generated from line E.3 of the Statement of Financial Position. *A loan to a licenceholder may be treated as a qualifying subordinated loan provided that —* *(a) it is in the same form as the model issued by the Authority;* *(b) it is signed by authorised signatories of all of the parties and the Authority has accepted it, in writing, as such; and* *(c) the licenceholder's net tangible assets are in excess of its minimum share capital requirement.* For the purpose of this calculation, only the amount of the loan actually advanced and outstanding may be counted as a qualifying subordinated loan. Guidance regarding the subordinated loans is available on the Authority's website.
D	Net Tangible Assets for Minimum Net Tangible Asset Requirement & Liquid Capital Requirement	This is calculated automatically, being A less subtotal B plus C.1.

CHAPTER 5 - CALCULATION OF LIQUID CAPITAL (PART B)

SECTION 1 – OVERVIEW

A licenceholder's calculation of liquid capital should be calculated in accordance with Appendix 3 Part B of the Rule Book. The instructions in section 2 provide additional information where necessary (*also refer to the instructions for the Statement of Financial Position in chapter 2 which are important*).

The calculation of liquid capital is designed to provide a proxy for net liquid assets (i.e. net assets that are cash or can be converted to cash) that could be used to meet obligations for the next 3 months. The proxy used for obligations is an assessment of 3 months expenses (refer chapters 6 and 7).

SECTION 2 - INSTRUCTIONS

Item	Nature of Item	Instructions
A	Net Tangible Assets for Liquid Capital Calculation	This is automated from line D of "Calculation of Net Tangible Assets – Part A".
B	Less (deductions)	
B.1	Tangible fixed assets	This is automated from line A.2 of the "Balance Sheet".
B.2	Fixed asset investments	The amount of fixed asset investments shown in line A.3 & A.4 of the Statement of Financial Position should be included here. Further, where an adjustment has been made to the book value of an investment in a subsidiary or associated company when calculating the net tangible assets (refer line B.2 of section 2, chapter 4) only the adjusted amount should be deducted to avoid double counting. Please refer to Chapter 10, section 7 for examples of how to calculate the figure in this section when it relates to a subsidiary entity.
B.3	Stock / inventories (excluding stocks of investments)	This is automated from line B.1.2 of the "Statement of Financial Position".
B.4	Debtors > 90 days	This is automated from line B.1.4 of the "Statement of Financial Position".

Item	Nature of Item	Instructions
B.5	Work in progress > 90 days	This is automated from line B.1.6 of the "Statement of Financial Position".
B.6	Prepayments > 90 days	This is automated from line B.1.8 of the "Statement of Financial Position".
B.7	Amounts due from related parties	This is automated from line B.2.2 of the "Statement of Financial Position".
B.8	Any other relevant items	A licenceholder must exercise appropriate judgement to include any items here that may not be covered by the defined categories of illiquid asset adjustments but nevertheless would be considered illiquid.
B.9	Market Value Adjustments	This is automated from line G in the calculation in table 1 "Market Value Adjustments".
B.10	Amounts given as guarantees or charges over assets	Where a licenceholder has obtained approval from the Authority to enter into a guarantee arrangement or give a charge over its assets, the amount of the guarantee and/or charge should be deducted from the Liquid Capital as follows: In respect of a mortgage or charge over assets in respect of a loan, the amount of the capital and interest outstanding; In respect of a floating charge, the amount secured by the charge; In respect of a guarantee for a specific amount, the amount guaranteed; In respect of an unlimited guarantee in respect of borrowings, the amount of existing loans drawn down over which the guarantee is in force. A contingent liability in respect of a Government grant for a specific expense is not regarded as a guarantee or charge for the purposes of the calculation.
B.11	Counterparty risk requirement	This is automated from the calculation of "counterparty risk requirement", being the sum of "total CRR for cash against documents" (section H), "total CRR for free deliveries" (section J) and "total CRR for options purchased" (section K).

Item	Nature of Item	Instructions
B.12	Term deposits > 90 days maturity	This is automated from line B.4.1 of the "Statement of Financial Position".
	<u>SUBTOTAL</u>	This is calculated automatically, being the sum of B.1 to B.12.
C	Additions	
C.1	Bank loans and lease obligations > 1 year	This is automated from line E.2 of the "Statement of Financial Position".
C.2	Non-refundable deferred income	This is automated from Line D.2 of the "Statement of Financial Position". The terms of business with the client must state that the fees are non-refundable in order for the deferred income to be included here.
C.3	Tax obligations > 1 year	This is automated from line E.5 of the "Statement of Financial Position".
C.4	Any other relevant items	A licenceholder must obtain the Authority's consent to add back any other items here that may not be covered by the defined categories of adjustments (excluding subordinated loans already added back in the calculation of net tangible assets).
	SUBTOTAL	This is calculated automatically, being the sum of C.1 to C.4.
D	Liquid Capital	This is calculated automatically, being A, less subtotal B, plus subtotal C.

Table 1 – Market Value Adjustments

This calculation feeds into line B.9 of the Liquid Capital Calculation.

Item	Nature of Item	Instructions
E	**<u>Market Value Adjustment</u>**	
E.1 to E.8	Various	Report the market value of these investments (which may be the same as the book value) in column 1. The figures in columns 2, 3, 4 and 6 are automatically generated. The figures in column 5 are generated from the Statement of Financial Position lines B.3.1 to B.3.8.
	<u>SUBTOTAL - Total Market Value Adjustment</u>	This is calculated automatically, being the sum of the amounts in column 6 for lines E.1 to E.8.
<u>F</u>	Settlement Adjustments	
F.1	Valuation adjustment for creditors outstanding for over 30 days after settlement date – excess of market value over creditor amount	Please refer to Appendix 3 note 6 of the Rule Book. In column 1 insert the market value of the underlying investments in relation to creditors arising from purchases of investments outstanding for 30 or more days from contractual settlement date. In column 2 insert the corresponding creditor amount. The figures in columns 3 and 6 are calculated automatically.
F.2	Valuation adjustment for amount paid in advance where delivery has been outstanding for more than 5 days	In column 6 insert the amount of any payment in advance for purchases of investments for which delivery has been outstanding for more than 5 working days.
	<u>SUBTOTAL – Total Settlement Adjustments</u>	**<u>This is calculated automatically, being the sum of the amounts in column 6 for lines F.1 to F.2.</u>**
<u>G</u>	**<u>TOTAL INVESTMENT ADJUSTMENTS</u>**	**<u>This is calculated automatically, being the sum of the subtotals E and F.</u>**

Counterparty risk requirement (CRR)

This calculation feeds line B.11 of the Liquid Capital Calculation. The CRR applies only to stockbrokers incorporated in the Isle of Man as per rule 2.34 of the Rule Book. A licenceholder's calculation of its CRR should be calculated in accordance with Appendix 4 of the Rule Book. These instructions provide additional information where necessary.

General requirements

1. Frequency of calculation

A licenceholder must calculate its counterparty risk requirement ("CRR") at least once each business day; for the purposes of the relevant calculations the licenceholder may use prices of investments and physical commodities as at the close of business on the previous day.

2. Negative amounts

A licenceholder must not include any CRR if it is a negative amount.

3. Instruments for which no CRR has been specified

Where a licenceholder is in doubt as to the classification of an item for the purposes of CRR, it must promptly seek advice from the Authority and until the Authority informs the licenceholder of the correct treatment in the CRR calculation, the licenceholder must add to its CRR the whole of the exposure on the item concerned.

4. Provisions

A licenceholder may reduce the exposure on which its CRR is calculated to the extent that it makes provision for a specific counterparty balance.

5. Associated companies and subsidiaries

For the avoidance of doubt, a licenceholder must calculate a CRR as appropriate on exposures to or from associated companies and subsidiaries.

6. Basis of valuation

For the purposes of valuing instruments and physical commodities at market value in the calculation of CRR, a licenceholder must be consistent in the basis it chooses and may use either mid-market value or bid and offer prices (as appropriate).

7. Acceptable collateral

A licenceholder may reduce the exposure to a counterparty on which its CRR is calculated to the extent that it holds acceptable collateral from that counterparty.

8. Nil weighted counterparty exposures

A licenceholder may disregard any counterparty exposure calculated in accordance with paragraphs 2 to 9, if the counterparty is or the contract is guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such government, province or state), which is a member of the OECD and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years.

9. Cash against documents transactions – section H of the reporting form

(1) A licenceholder which enters into a transaction on a cash against documents basis must calculate the market risk for transactions still unsettled 16 calendar days after settlement date as set out in (2) below and must then multiply this by the appropriate percentage set out in Table A below to calculate a CRR for each separate unsettled transaction.

Table A – percentage to be applied to market risk

Calendar days after settlement day	Percentage
0-15	Nil
16-30	25%
31-45	50%
46-60	75%
Over 60	100%

(2) Market risk calculation:
(a) Where a licenceholder has neither delivered securities nor received payment when purchasing securities for, or selling securities to, a counterparty, the market risk is the excess of the contract value over the market value of the securities.

(b) Where a licenceholder has neither received securities nor made payment when selling securities for, or purchasing securities from, a counterparty, the market risk is the excess of the market value over the contract value of the securities.

(3) The sum of the amounts calculated in accordance with (1) and (2) above is the licenceholder's total CRR for cash against documents transactions.

For the purposes of the reporting forms the licenceholder need only enter the contract value and market value amounts. The reporting form automatically calculates the CRR.

10. Free deliveries of securities – section J of the reporting form

(1) When a licenceholder makes delivery to a counterparty of securities without receiving payment or pays for securities without receiving the certificates of good title, the licenceholder must calculate the free delivery value for each transaction.

(2) A licenceholder must calculate the free delivery value for each transaction as set out below and multiply this value by the appropriate percentage in Table B below for free deliveries of securities as follows –
(a) if the licenceholder has delivered securities to a counterparty and has not received payment, the free delivery amount is the full amount due to the licenceholder (i.e. the contract value);
(b) if the licenceholder has made payment to a counterparty for securities and not received the certificates of good title, the free delivery amount is the market value of the securities.

(3) The sum of the amounts calculated in accordance with (1) and (2) above is the licenceholder's total CRR for free deliveries of securities.

For the purposes of the reporting forms the licenceholder need only enter the contract value and market value amounts. The reporting form automatically calculates the CRR.

Table B - Percentage to be applied to free deliveries relating to securities

Nature of counterparty to whom free delivery is made		Business days since delivery		
		0-3	4-15	Over 15
1	A counterparty to whom securities have been delivered or to whom payment for securities has been made.	Nil	100% of contract or market value	100% of contract or market value
2	A regulated financial institution or regulated banking institution to whom securities have been delivered or payment made with the expectation that market practice will result in a settlement day longer than three days from delivery date.	15% of contract or market value		100% of contract or market value
2 A	A counterparty to whom securities have been delivered which settle through the Crest or to whom payment for such securities has been made.	15% of contract or market value		100% of contract or market value
3	A Manager, underwriter, sub-underwriter or member of a selling syndicate or issuer to whom payment for securities has been made; or a manager of a regulated collective	Nil		100% of contract or market value or, if the issue is a country approved by the Authority, 15% of the

	investment scheme to whom units of the scheme have been delivered or payment for units of the scheme has been made.		contract or market value.

11. Options purchased for a Counterparty – section K of the reporting form

(1) Single premium options.

Where a licenceholder has purchased a single premium option on behalf of a counterparty and the counterparty has not paid the full option premium cost within three business days after trade date, a licenceholder must calculate a CRR as the amount by which the option premium owed to the licenceholder exceeds the market value of the option or acceptable collateral. For the purposes of the reporting forms the licenceholder must enter the option premium amount and the market value of the option. The CRR is calculated automatically.

(2) Traditional options.

Where a licenceholder has purchased a traditional option for its own account or a counterparty and paid the option premium, it must calculate a CRR equal to the value of the option premium. For the purposes of the reporting forms the licenceholder must enter the option premium amount. The CRR is calculated automatically.

(3) The sum of the amounts calculated in accordance with (1) and (2) above is the licenceholder's CRR in respect of purchased options. This is calculated automatically in the reporting forms.

CHAPTER 6 – FRS - CALCULATION OF ANNUAL AUDITED EXPENDITURE (APPENDIX 3 - PART C)

SECTION 1 – OVERVIEW

A licenceholder's calculation of its annual audited expenditure (AAE) and should be calculated in accordance with Appendix 3 Part C of the Rule Book. The instructions in section 2 provide additional information where necessary.

This calculation is used to show the average recurring expenses for a licenceholder for a 3 month period. It is compared to a licenceholder's liquid capital (Part E 'Liquid Capital Requirement') to help demonstrate that a licenceholder could be wound down in an orderly manner if necessary.

SECTION 2 - INSTRUCTIONS

Calculation of Annual Audited Expenditure (AAE) and Expenditure Based Requirement (EBR)

In any INTERIM FRS, a licenceholder's AAE should be taken from the most recent ***audited financial statements***, unless:

- it is the licenceholder's first period of business. In which case, figures from the licenceholder's business plan should be used;

  The licenceholder has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the licenceholder; or
- the licenceholder's business has significantly changed since the audited financial statements were published. In which case, current (enhanced) figures should be used. The Authority may request sight of the licenceholder's amended financial forecasts. In accordance with rule 2.30, Appendix 3, Note 11, an adjustment to a licenceholder's AAE and EBR must be agreed with the Authority.

The third scenario above may indicate a change to the nature of business activities undertaken. In accordance with rule 8.11(3)(b)(ii), the licenceholder should consider whether it is necessary to submit an updated business plan. .

As noted above under bullet point 3, any changes to a licenceholder's AAE and EBR should be agreed with the Authority.

When a licenceholder is winding down or in the process of surrendering their licence, the Authority appreciates that the latest AAE may not be a true reflection of the expenses going forward for that licenceholder. Therefore, the licenceholder should contact the Authority and provide the Authority with budgets/forecasts for the expenditure going forward which the licenceholder deems more appropriate to base the EBR. The Authority can, where appropriate, agree a different figure to be used for the purposes of this calculation. The Authority would expect detailed budgets/forecast to include costs of liquidation/dissolution where appropriate.

For an Annual FRS, a licenceholder's AAE should be taken from that period's audited financial statements (not the previous year). Exchange gains / losses should be excluded and refunds cannot be netted off against expenses.

Chapter 10 (section 5.1) provides a summary of which period of account to use for Interim FRS and Annual FRS.

Item	Nature of Item	Instructions
A	**Audited Expenditure (all figures will normally be as per the audited financial statements unless agreed otherwise by the Authority)**	
A.1	Operating expenses	All expenses should be included in operating expenses except where: • commissions are paid to third parties but only where this is based on a percentage of earned commission or other income by the licenceholder and included in turnover. In such instances, the commissions or other income paid/payable must be treated as a "cost of sale" rather than an operating expense within the Profit and Loss or the Income and Expenditure Account; and/or • another regulated company (in the same group) provides client related services to the licenceholder under a formal agreement and the fees paid / payable to that group company are reasonable and directly attributable to the fees earned by the licenceholder. In such circumstances the fees paid / payable may be treated as a "cost of sale" rather than an overhead expense within the Profit and Loss or the Income and Expenditure Account. The Authority expects licenceholders and their auditors to break down operating expenses appropriately for the regulated activity being undertaken (within the annual return). If items are "consolidated" within operating expenses the Authority may request a further detailed breakdown.

		Fees, brokerage and other charges paid to clearing houses, exchanges, approved exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions may be treated as a "cost of sale" (and therefore not be an operating expense).
A.2	Interest payable	Appendix 3 note 13 of the Rule Book states "Netting off is not permitted under any circumstances, for example, interest payable must not be "netted off" against interest receivable. Interest payable must be treated as an expense."
A.3	Tax expense	Report the figure as per the last audited financial statements (tax refunds cannot be included here).
A.4	Other expenses	Appendix 3 note 14 of the Rule Book states that these should be as agreed in advance with the Authority. Any amounts reported should reflect specified expenses as per the last audited financial statements.
	Total Audited Expenditure	This is calculated automatically, being the sum of A.1 to A.4.
B	Adjustments to expenditure	
B.1	Discretionary bonuses / profit share	Any form of discretionary (i.e. not contractual) profit related bonus payable to employees, directors, partners or proprietors made can be deducted from operating expenses for the purposes of the expenditure based requirement and may be reported here.
B.2	Depreciation / amortisation	Report the amount as per the last audited financial statements. This is deducted because it is not a cash expense.
B.3	Bad debt expense	Where a bad debt provision relates to a debtor that has been "disallowed" in the calculation of liquid capital, the related expense may be reported here and included as an adjustment when arriving at the Annual Audited Expenditure

B.4	Exceptional and extraordinary costs	Report here exceptional items and extraordinary items (exceptional items to be agreed in advance with the Authority – see appendix 3, note 17 to the Rule Book) either as defined in UK FRS 102, paragraph 5.10 or IAS 1. Examples given in IAS 1 include asset write downs, restructuring costs, profit or loss on disposal of assets, discontinuing operations and reversal of provision. Litigation settlements would not be acceptable as deductions unless the litigation concluded during the relevant financial year and there are no ongoing costs. Items can only be excluded here if they are defined as exceptional or extraordinary in the financial statements, or with consent from the Authority.
	Total adjustments to expenditure	**This is calculated automatically, being the sum of B.1 to B.4.**
C	**Annual Audited Expenditure (AAE) – Based on Period of Account**	**This is calculated automatically, being the total audited expenditure (A) less the total adjustments (B).**
D	Length of period of financial statements	Enter here the actual period of the audited financial statements as a whole number of months (e.g. 12).
E	**Annual Adjusted Expenditure (12 months) (AAE)**	**This is calculated automatically, being the amount in C multiplied by 12 and divided by the figure reported in D.**
F	**Expenditure Based Requirement (AAE * ¼)**	**This is the calculated automatically, being the amount in E divided by 4.**

CHAPTER 7 – FRS - CALCULATION OF LIQUID CAPITAL REQUIREMENT *(APPENDIX 3 - PART D)*

SECTION 1 – OVERVIEW

A licenceholder's calculation of its Liquid Capital Requirement ("LCR") should be calculated in accordance with Appendix 3 Part D of the Rule Book. The instructions in section 2 provide additional information where necessary.

Part D sets out minimum standards of surplus liquid assets to be retained in the business, sufficient to meet the licenceholder's expenditure for a specific period in the event of the need to have an orderly wind-up of the licenceholder.

The LCR for the licenceholder needs to reflect the approximate replacement costs of the directors' time, irrespective of whether they draw a salary. Where one or more directors draws no, or only a minimum, salary an approximation of the replacement cost of the directors' time should be included in Part D (cell A.3). The amount to be included should be based on a market rate for a person to cover the responsibilities and reflect the amount of time spent on the business of the licenceholder. The figure should be based on cover for three months. This does not alter the expenses (and this notional figure should not be included in the statement of profit and loss). This would not affect the reconciliation between the audited accounts and the FRS.

SECTION 2 - INSTRUCTIONS

Item	Nature of Item	Instructions
A	Liquid Capital Requirement	
A.1	Expenditure Based Requirement	This is automated from line F of Part C "Calculation of Annual Audited Expenditure and Expenditure Based Requirement".
A.2	Excess on PI insurance (if applicable)	Appendix 3 note 18 of the Rule Book states "the licenceholder should maintain liquid capital to be able to fund the excess on one potential claim on the PI insurance policy, except where a letter of support is in place from a group company when an amount of zero may be entered." This must be agreed in advance with the Authority. Where a letter of comfort is in place to support the PII excess, a copy of the latest audited financial statements of the entity providing the letter must be submitted annually (Per Rule 8.28(4)).

Item	Nature of Item	Instructions
A.3	Other	As determined by the Authority (e.g. a deduction for contingent liabilities if required or approximate replacement costs of the directors' time where they draw no or minimal salary, as noted above).
	Total Liquid Capital Requirement	**This is calculated automatically, being the sum of A.1 to A.3.**

CHAPTER 8 – FRS - CALCULATION OF FINANCIAL RESOURCES *(APPENDIX 3 - PART E)*

SECTION 1 – OVERVIEW

A licenceholder's calculation of its financial resources should be calculated in accordance with Appendix 3 Part E of the Rule Book. The instructions in section 2 provide additional information where necessary.

SECTION 2 - INSTRUCTIONS

Minimum share capital requirement

Licenceholders are required to have a minimum amount of issued share capital (including paid-up share premium) in accordance with Appendix 2 of the Rule Book.

Any changes in the capital structure of a licenceholder should be approved by the Authority in accordance with rules 7.7 and 7.8 of the Rule Book.

Item	Nature of Item	Instructions
A	Minimum share capital requirement	
A.1	Paid up share capital / share premium	This is automated from the "Statement of Financial Position" being the sum of lines F.1 and F.2.
A.2	Less minimum share capital / share premium requirement (insert value as a positive figure).	Insert the minimum requirement as per Appendix 2 of the Rule Book. This is also contained in the form template.
	Surplus / (Deficit)	**This is calculated automatically, being A.1 less A.2. A deficit must be reported immediately.**

Minimum net tangible asset requirement

A licenceholder's net tangible assets (calculated in accordance with Appendix 3 Part A of the Rule Book) must not be less than the minimum required for the appropriate Class in Appendix 2 of the Rule Book.

A licenceholder should notify the Authority if their minimum net tangible assets are, or may fall, below the requirement, or 110% of that amount, in accordance with rule 2.31 of the Rule Book. The 110% level is used as an indicator / buffer to highlight whether the licenceholder is getting close to breaching the minimum requirements.

Item	Nature of Item	Instructions
	Minimum net tangible asset requirement	
B	Net Tangible Assets	This is automated from "Part A – Net Tangible Assets" line D.
C	Less minimum net tangible asset requirement (insert value as a positive figure)	Insert the minimum requirement as per Appendix 2 of the Rule Book. This is also contained in the template.
	Surplus / (Deficit)	**This is calculated automatically, being B less C. A deficit must be reported immediately.**
	110% of Total Net Tangible Asset Requirement	**This is calculated automatically, being the figure reported in C multiplied by a factor of 1.1.**
	Notification Level Reached	**This will state "yes" or "no" based on whether the figure reported in line B is below or above the 110% requirement.**

Liquid Capital Requirement

The liquid capital requirement should be calculated in accordance with Appendix 3 Part D of the Rule Book. A licenceholder must immediately notify the Authority if at any time it has reason to believe that its liquid capital is, or may fall, below the requirement or 110% of that amount, in accordance with rule 2.31 of the Rule Book. The 110% level is used as an indicator / buffer to highlight whether the licenceholder is getting close to breaching the minimum requirements.

This requirement is designed to measure the ability of the licenceholder to meet short term obligations (3 months) from its own resources. It uses liquid capital (a measure of net liquid assets) and compares this against a requirement based on 3 months expenses, adjusted for expenses that could be reduced or eliminated (or have no cash-flow), with a buffer for a claim on its Professional Indemnity Insurance.

Item	Nature of Item	Instructions
	Liquid capital requirement	
D	Liquid Capital	This is automated from "Part B – Liquid Capital Calculation" line D.
E	Liquid capital requirement	This is automated from "Part D – Calculation of Liquid Capital Requirement" total for A.
	Excess / (shortfall) of Liquid Capital	**This is calculated automatically, being D less E. A shortfall must be reported immediately.**
	110% of Total Liquid Capital Requirement	**This is calculated automatically, being the figure reported in E multiplied by a factor of 1.1.**
	Notification Level Reached	**This will state "yes" or "no" based on whether the figure reported in line D is below or above the 110% requirement.**

CHAPTER 9 - GENERAL

Nil balances and sign convention

Where there is a £nil balance, do not enter anything in the relevant cell.

The software automatically calculates the figures reported in some cells of the reporting forms. Generally, figures should be reported using a positive sign convention unless otherwise stated in the specific notes for completion of each form.

Reporting currency

Rule 2.3 states: *"Any financial return made by a licenceholder must be expressed in sterling unless the licenceholder has obtained the Authority's prior approval to report in another currency".*

Licenceholders should ensure the currency which they are reporting in is inserted into the relevant sections of the FRS i.e. on cell 6D of the Statement of Financial Position. The currency only needs to be manually entered into this cell, as the rest of the form is linked to this cell, therefore will automatically update in the required sections.

Netting

Assets and liabilities and income and expenses should be disclosed separately as far as possible, and not be offset, to aid the Authority's understanding of the business.

Debit balances should not be set-off against credit balances unless there is a legally enforceable specific netting agreement in place between the licenceholder and its counterparty or customer, or accounting standards allow such netting.

Specific references to netting are also contained in Appendix 3 of the Rule Book, including note 5 (amounts due from related parties) and note 13 (interest payable). In particular, note 5 requires the Authority's prior written consent to allow settlement of related party balances on a net basis.

In respect of Appendix 3 Note 13, whilst netting-off is generally prohibited it may be exercised where:

a) a legally enforceable specific netting agreement is in place between the licenceholder and its counterparty or customer (with the prior consent of the Authority); or
b) it is a government grant in relation to a specific expense.

Note: A current tax asset and current tax liability should only be offset by a licenceholder where it has a legally enforceable right to set off the amounts and it intends to settle them on a net basis. If the amounts are not settled on a net basis then they should be settled simultaneously.

Deferred tax assets and liabilities should similarly only be offset where the licenceholder has a legally enforceable right to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities have arisen on income taxes levied by the same taxation authority. In addition, the amounts should be in relation to the same taxable entity, or where they have arisen in respect of different taxable entities there should be the right to settle the amounts on a net basis or simultaneously.

Accounting standards

Rule 2.10 states: *"Except where otherwise provided, any financial return which is required by this Rule Book to be submitted to the Authority must be prepared in accordance with either —*

- *(a) any applicable Financial Reporting Standards issued or adopted from time to time by the Accounting Standards Board in the United Kingdom;*
- *(b) the Statement of Recommended Practice; or*
- *(c) any International Financial Reporting Standards published from time to time by the International Accounting Standards Board."*

The electronic forms for interim returns take into account both standards, but in places regulatory requirements and descriptions differ from statutory accounting requirements and terminology.

Specific requirements for class 8(2)(a) and 8(4) licenceholders:
In preparing financial returns, "relevant funds" must not be included in the calculations of net tangible assets and liquid capital and therefore must be excluded from the reported data. However, any "restricted funds" can be included.

Responsibilities

Rule 2.4 states: *"Any person who is a responsible officer in relation to a licenceholder is responsible for the completeness and accuracy of any financial return made to the Authority by or in respect of the licenceholder."*

The persons designated under 2.4 of the Rule Book need not themselves be the resident officers of the licenceholder.

Misleading information

Rule 2.5 states:

"A licenceholder must notify the Authority as soon as it has reason to believe that any financial return previously made by it to the Authority was or has become misleading in any material respect".

Materiality should be considered as an amount, disclosure or previous error which, if not disclosed to the Authority, would or may affect the Authority's view of the licenceholder. The assessment of materiality is a matter of professional judgement on the part of the licenceholder.

If, but for the error, a licenceholder would have made a notification under Rule 2.31 (notification of actual or potential breach) then the error is material.

Interim Financial Returns

Rule 2.33(Application column) identifies the licenceholders which are required to file interim financial returns using the Financial Reporting System. Licenceholders which also conduct Class 1 business (deposit taking) are not required to complete the interim returns detailed in these Procedural Instructions.

Rule 2.33 also requires a licenceholder to prepare an unaudited interim financial return at the end of each quarter, which includes as at its financial year end, within one month after the end of the period to which the return relates.

Rule 2.35 covers interim financial resources calculations for those licenceholders who are not required to submit them electronically to the Authority. This Rule requires a licenceholder to evidence and document its compliance with Rule 2.30 at least once in each quarter, no later than one month following the period to which it relates.

Submission format

The Interim FRSs should be submitted in electronic format, using the electronic reporting forms and via the Authority's financial reporting system. If a licenceholder cannot submit its Interim FRS electronically, a request for an alternative method should be made to the Authority in the first instance.

If insufficient space is provided within a particular section of the electronic reporting forms, an appendix should be submitted to the Authority in electronic or hard copy format. The template forms are shown on the Authority's website.

The Authority is aware that technical errors can occur in the electronic submission of interim returns. If this occurs during the submission process, a licenceholder should contact the IT manager at the Authority in the first instance.

Relationship to audited financial statements

The electronic reporting forms sometimes require items to be treated in a way that differs from the licenceholder's practice for preparing its financial statements. Where there are differences in treatment, a reconciliation should be provided to the Authority with an explanation of the differing treatment of reconciling items.

Group companies and associated companies

The definitions below of parties related to the licenceholder may not necessarily concur with those applied by the licenceholder's auditors under current accounting standards. Disclosure in the annual audited financial statements should continue to be guided by current accounting standards.

Group is defined in section 48 of the Financial Services Act 2008:

"in relation to a company, means that company, any other company which is its holding company or subsidiary and any other company which is a subsidiary of that holding company".

Group Company is defined in appendix 1 of the Rule Book:

"In relation to a licenceholder, means a company, trust or foundation which is a member of the same group as the licenceholder".

Subsidiary company

A subsidiary company is defined in section 48 of the Financial Services Act 2008:
"means a body corporate (whether or not incorporate under the Companies Acts 1931 to 2004) that is a subsidiary of another body corporate (whether or not incorporated under those Acts) and in determining whether one body corporate is a subsidiary of another the provisions of section 1 of the Companies Act 1974 shall apply with the necessary modifications, and "holding company" shall be construed accordingly."

Associated company

An associated company is defined in the Rule Book under Appendix 1 as:

- (a) any company in which the licenceholder holds more than 20% of the equity shares; or
- (b) a company, other than a subsidiary, over which the licenceholder is able to exercise a significant influence, and in which the licenceholder's interest is either
  - (i) effectively that of a partner in a joint venture or consortium; or
  - (ii) both long-term and substantial.

CHAPTER 10 – COMMON ERRORS AND ISSUES (for licenceholders and their auditors)

The Authority identifies errors and issues in the reporting of information by licenceholders, in Interim FRS and Annual FRS . Although the guidance contained in chapters 1 to 9 is designed to help eliminate such errors occurring, common mistakes and other issues are highlighted below.

1. Intercompany loans – netting

The Authority has found that in some cases debtor and creditor balances have been netted off, with a net figure reported in the Statement of Financial Position (reference lines B.2.1, B.2.2, D.4 or E.4 of the Statement of Financial Position).

Netting has been made where the borrower and lender is the same group company and also when the borrower and lender are different group companies. This has occurred in both Interim FRS and Annual FRS submissions and the Authority has requested breakdowns of the balances in some cases.

The Authority would only expect such balances to be netted off as described in chapter 9.

2. Intercompany loans – repayment terms and treatment for liquidity purposes

The Authority has found that in some cases licenceholders have relied on “liquid” intercompany debtors (reported as due within 3 months) to be able to demonstrate compliance with the liquid capital requirements.

The Authority expects licenceholders to consider the recoverability of the loans within the short term in the preparation of the Interim FRS and Annual FRS. The Authority also expects auditors to assess the treatment of these loans for liquid capital purposes as part of the Annual FRS submission.

3. Debtors and WIP – treatment for liquidity purposes

The Authority considers that the disclosure of debtors (lines B.1.3 and B.1.4 of the Statement of Financial Position) and WIP (lines B.1.5 and B.1.6 of the Statement of Financial Position) requires particular attention by licenceholders, and auditors as part of the annual FRR requirements. In the past the Authority has found errors in the reporting of such debtors or WIP between under and over 90 days.

The principle for debtors is that they are disallowed (i.e. reported as due after 90 days) unless payment is expected to be received within 90 days of the Statement of Financial Position (reporting date), based on management’s estimate (for example through the use of aged debtor reports etc and past history of collections). At a minimum any debtors which have been overdue for more than 90 days at the Statement of Financial Position date must be disallowed and reported as being due after 90 days (as there is more risk that these debts may go bad and eventually be written down).

4. Liquid capital (Part B of FRS) and Liquid Capital Requirement (Part D of FRS)

4.1 – Fixed asset investments

Fixed asset investments are deducted from net tangible assets in the calculation of liquid capital (in line B.2). Line B.2 is not however automatically linked to the Statement of Financial Position report within the FRS spreadsheet (due to the way in which adjustments to investments in subsidiaries and associates are made). This has resulted in some licenceholders failing to manually enter the correct figure in line B.2.

4.2 – Table 1 (market values)

The Authority has identified that some licenceholders have omitted the market values from table 1 which can result in errors being translated to line B.9 of the liquid capital calculation.

It is important that these values are entered correctly as failure to do so can result in an overestimation of actual liquid capital.

4.3 – PII excess

The Authority has found that this is often entered incorrectly and care should be taken to ensure the correct information is included. *Failure to do so can result in an underestimation of the liquid capital requirement.*

5. Annual Audited Expenditure (AAE) and Expenditure Based Requirement (EBR) (Part C of FRS)

5.1 – Which period of account to use?

Some licenceholders do not use the correct period's figure when completing Part C, in both the Interim FRS and Annual FRS submissions. This results in errors being carried over to Part D, and the calculation of the financial resources requirement in Part E.

The correct period of account to use is explained below:-

Interim FRS

The latest annual audited figures should be used. For example, if your year end is 31 December 2016, and you are preparing an interim return for 31 December 2016 (for submission by 31 January 2017), the expense figures used should be the audited 31 December 2015 figures, being the latest annual audited figures.

Following on, for the interim return for 31 March 2017 (for submission by 30 April 2017), the 31 December 2016 audited expense figure should be used.

Annual FRS

The annual audited figures for that year should be used. For example, if the year-end is 31 December 2016 (audited Annual FRS due to be submitted by 30 April 2017), then the expenses used should be for the year ended 31 December 2016. Some licenceholders have mistakenly been using the prior year (31 December 2015 in this example) audited expenditure figures.

<u>5.2</u> – Operating expenses (and cost of sales)

Only certain expenses can be treated as "cost of sales" in accordance with the guidance. Cost of sales do not count towards the AAE and EBR and therefore disclosing / treating actual operating expenses as cost of sales (whether in error or deliberately) must be avoided as this can result in the underestimation of the AAE and EBR.

Examples of operating expenses that licenceholders have incorrectly included in "cost of sales" in ANNUAL FRS submissions include:-

- Entertainment
- Travel
- Group management fees not directly attributed to fees earned

<u>5.3</u> – Adjustments (bonuses and profit shares)

Bonus payments can be included in Part C line B.1. The reporting of bonus payments reduces the AAE and EBR which results in a lower liquid capital requirement in Part D. The Authority has also noted that sometimes "dividends" have been included in line B.1 for owner managed businesses, which is incorrect.

The Authority may query unusually high bonus amounts (compared to salary costs) in reviews of Annual FRS submissions and auditors should check to ensure that only valid discretionary bonus amounts are included in line B.1.

<u>5.4</u> – Adjustments (exceptional costs)

The Authority has found some licenceholders have included costs as "exceptional costs" when they should not have. The guidance explains when costs can be treated as exceptional for this purpose.

Inclusion of non-exceptional costs must be avoided as this reduces the AAE and EBR and results in a lower (but incorrect) liquid capital requirement.

<u>5.5</u> – Changes to the AAE and EBR during the year

The Authority has observed that some licenceholders have used different figures in the AAE / EBR calculation during the year (in submission of the INTERIM FRS), and outside of the normal annual change. For example, actual current year's cumulative (un-audited) figures have been used.

Any changes to a licenceholder's AAE and EBR during the year need to be approved or made by the Authority. There is additional guidance already included for the first period of operation.

6. Miscellaneous

6.1 – Using consolidated figures

Some licenceholders have found to be using "consolidated figures" in the Interim FRS when they have operating subsidiaries. Interim FRS must be made on an unconsolidated basis in accordance with the Rule Book. If the Authority also considers it would be beneficial to receive consolidated returns it would contact the licenceholder accordingly.

6.2 – Management commentary

If there are significant fluctuations in figures from one interim return to the next it can be useful to provide an explanation of these when submitting the returns.

6.3 - Rule 2.32(c)

Licenceholders are required by Rule 2.35 to: "evidence and document its compliance with the requirements of rule 2.30 at least once in each quarter, no later than one month following the period to which it relates"

Rule 2.32(c) asks licenceholders to confirm that there are no differences between the Annual FRS and the interim FRS prepared (as required by 2.35) at the year-end date, **or** to provide a reconciliation of any differences between the two.

For the avoidance of doubt, the Authority expects either a reconciliation showing the differences between the Interim FRS (e.g. at 31 December 2016) and the audited Annual FRS (again, at 31 December 2016 if that is the year end date). The reconciliation must clearly show the amount of the adjustment, and an explanation for the adjustment for example why the figure wasn't included on the interim return, and what the adjustment relates to.

Where there are no differences or adjustments between the Interim FRS and the Annual FRS, the licenceholder should confirm this is the case.

In addition, Rule 5.17 requires the auditor to confirm that the reconciliation has been prepared. Again, if there are no differences or adjustments, the auditor should state the same.

7. Accounting for losses in subsidiary entities or associated companies within the FRS.

Part A - Calculation of NTA.

The NTA calculation starts with the Capital & Reserves figure (also known as 'Shareholders Funds') from the figure shown on the licenceholder's Statement of Financial Position. Shareholders' funds is equal to assets less liabilities.

Therefore, theoretically, Capital & Reserves includes the book value of subsidiary and associated companies.

Example of a simple Statement of Financial Position:

	£
Assets (investments, cash, debtors etc)	100,000
Liabilities (creditors, loans, overdrafts etc)	(50,000)
Net assets (Total Assets less Total Liabilities)	50,000
Share capital	40,000
Profit & loss reserves	10,000
Total shareholders' funds	50,000

An adjustment is required on line B.2 of Part A of the FRS "any accumulated losses of subsidiaries or associated companies" where a trading subsidiary has incurred accumulated losses.

Part B - "Calculation of Liquid Capital".

There are potentially two types of adjustments in row B.2 Fixed Asset Investments, as follows:

1. Where a subsidiary is non-trading, and has either a zero balance or positive profit and loss reserves figure, the book value (as per the amount shown in row A.3 of the balance sheet of the licenceholder) in the subsidiary or associated entity must be deducted.
2. Where the subsidiary is either a trading entity, or has traded in the past and has incurred accumulated losses. The required treatment is explained in the 4 different scenarios/examples outlined below.

The amount invested by a licenceholder into a subsidiary/associated company (adjusted value where applicable) is not a liquid asset for the purpose of the liquid capital calculation.

The NTA figure is taken from Part A. The book value of the subsidiary/associated company is included in that figure but is shown after any adjustment in Part A.

Required treatment where a trading subsidiary has incurred accumulated losses and/or has negative shareholders' funds.

In all of the following examples

(i) A Ltd is the parent entity (usually the licenceholder)
(ii) A Ltd owns 100% of B Ltd shares.
(iii) B Ltd share capital is 100,000 ordinary shares of £1 each, therefore the share capital is £100,000.
(iv) Both entities have the same financial reporting year end.
(v) The adjustments to the FRS are referring to A Ltd as being the licenceholder and the parent entity.

Example 1

A Ltd is showing the cost of the investment as £100,000 in its Statement of Financial Position.

B Ltd's Shareholders funds are as follows:

Share Capital	£100,000
Profit & loss reserves	(£60,000)
Shareholders' funds	£40,000

Adjustments to the FRS:

a. Part A - £60,000.

There has been a reduction in A Ltd's assets of £60k, which had not been accounted for.

b. Part B – £40,000.

This is because the Authority recognises that the investment in the subsidiary is an asset of the Parent, however it is not deemed to be a liquid asset.

Example 2

A Ltd is showing the value of the investment as £40,000 in its Statement of Financial Position. The investment has been impaired during the year from £100,000 (cost) to £40,000.

B Ltd's Shareholders funds are as follows:

Share Capital	£100,000
Profit & loss reserves	(£60,000)
Shareholders' funds	£40,000

Adjustments to the FRS:

a. Part A - £0.

The reduction in the value of the investment has already been accounted for in A Ltd profit and loss account because the value of the investment has been impaired from £100,000 to £40,000.

b. Part B – £40,000.

This is because the investment in the subsidiary is not deemed to be a liquid asset.

Example 3

A Ltd is showing the cost of the investment as £100,000 in its Statement of Financial Position.

B Ltd's Shareholders funds are as follows:

Share Capital	£100,000
Profit & loss reserves	(£160,000)
Shareholders' funds	(£60,000)

Adjustments to the FRS:

a. Part A - line B.2 £160,000.

Deducting £160k eliminates the £100k value of the investment, and brings the overall value of B Ltd down to a negative £60k.

b. Part B – £0.

There is no deduction, the reduction in assets has already been accounted for in Part A. The investment was being shown as £100k which is included in the capital and reserves figures on Part A, then £160k has been deducted, therefore the net effect on the assets of the licenceholder is £100k -£160k = (£60K). The loss incurred by the subsidiary has been reflected in Part A.

Example 4

The investment has been impaired during the year from £100,000 (cost) to £0. The reduction in value of £100,000 has been recognised in the profit and loss account of A Ltd.

B Ltd's Shareholders funds are as follows:

Share Capital	£100,000
Profit & loss reserves	(£160,000)
Shareholders' funds	(£60,000)

Adjustments to the FRS:

a. Part A - £60,000.

There has been a reduction in A Ltd's net tangible assets of £60k. The investment cost has already been impaired to £0 therefore the accumulated loss on reserves of £60k needs to be deducted.

b. Part B – £0.

No adjustment is required, because the cost of the investment is already show as zero, and the adjustment in Part A reduces the position to the correct amount of negative £60k.