SCHEDULE 6

Regulation 10

ACCOUNTING PRINCIPLES AND RULES

PART I

ACCOUNTING PRINCIPLES

Preliminary

1. Subject to paragraph 7 below, the amounts to be included in respect of all items shown in a society's annual accounts must be determined in accordance with the principles set out in paragraphs 2 to 6 below.

Accounting principles

2. The society is presumed to be carrying on business as a going concern, and so, where group accounts are prepared, is the society and its subsidiaries.

3. Accounting policies must be applied consistently within the same accounts and from one financial year to the next.

4. The amount of any item must be determined on a prudent basis, and in particular:

(a) Subject to note (9) on the income and expenditure accounts format, only income arising by the balance sheet date must be included in the income and expenditure account; and

(b) all liabilities and losses which have arisen or are likely to arise in respect of the financial year to which the accounts relate or a previous financial year must be taken into account, including those which only become apparent between the balance sheet date and the date on which it is signed on behalf of the committee of management in pursuance of section 76 of the Act.

5. Except so far as these Regulations otherwise specify, income and charges relating to the financial year to which the accounts relate must be taken into account, without regard to the date of receipt or payment.

6. In determining the aggregate amount of any item the amount of each individual asset or liability that falls to be taken into account must be determined separately.

PART II

DEPARTURE FROM ACCOUNTING PRINCIPLES

7. If it appears to the committee of management of a society that there are special reasons for departing from any of the principles stated above in preparing annual accounts in respect of any financial year, they may do so, but particulars of the departure, the reasons for it, and its effect must be given in a note to the accounts.

PART III

CURRENT VALUE ACCOUNTING RULES

Preliminary

8.—(1) Subject to paragraphs 15 to 17 below:

(a) the amounts to be included in respect of assets of any description mentioned in paragraph 10 below must be determined in accordance with that paragraph; and

(b) subject to paragraph 9 below, the amounts to be included in respect of assets of any description mentioned in paragraph 11 below may be determined in accordance with that paragraph or the rules set out in paragraphs 18 to 31 below ("the historical cost accounting rules").

9. The same valuation method must be applied to all investments included in any item in the balance sheet format which is denoted by an arabic number.

Valuation of assets: general

10.—(1) Subject to paragraph 12 below, investments falling to be included under Assets item B (investments) must be included at their current value calculated in accordance with paragraphs 13 and 14 below.

(2) Investments falling to be included under Assets item C (assets held to cover linked liabilities) must be shown at their current value calculated in accordance with paragraphs 13 and 14 below.

11.—(1) Intangible assets other than goodwill may be shown at their current cost.

(2) Assets falling to be included under Assets items F.I (tangible assets) in the balance sheet format may be shown at their current value calculated in accordance with paragraphs 13 and 14 below or at their current cost.

(3) Assets falling to be included under Assets item F.II (stocks) may be shown at current cost.

Alternative valuation of fixed-income securities

12.—(1) This paragraph applies to debt securities and other fixed-income securities shown as assets under Assets items B.II (investments in associated bodies) and B.III (other financial investments).

(2) Securities to which this paragraph applies may either be valued in accordance with paragraph 10 above or their amortised value may be shown in the balance sheet, in which case the provisions of this paragraph apply.

(3) Subject to sub-paragraph (4) below, where the purchase price of securities to which this paragraph applies exceeds the amount repayable at maturity, the amount of the difference:

(a) must be charged to the income and expenditure account; and

(b) must be shown separately in the balance sheet or in the notes to the accounts.

(4) The amount of the difference referred to in sub-paragraph (3) above may be written off in instalments so that it is completely written off when the securities are repaid, in which case there must be shown separately in the balance sheet or in the notes to the accounts the difference between the purchase price (less the aggregate amount written off) and the amount repayable at maturity.

(5) Where the purchase price of securities to which this paragraph applies is less than the amount repayable at maturity, the amount of the difference must be released to income in instalments over the period remaining until repayment, in which case there must be shown separately in the balance

sheet or in the notes to the accounts the difference between the purchase price (plus the aggregate amount released to income) and the amount repayable at maturity.

(6) Both the purchase price and the current value of securities valued in accordance with this paragraph must be disclosed in the notes to the accounts.

(7) Where securities to which this paragraph applies which are not valued in accordance with paragraph 10 above are sold before maturity, and the proceeds are used to purchase other securities to which this paragraph applies, the difference between the proceeds of sale and their book value may be spread uniformly over the period remaining until the maturity of the original investment.

Meaning of "current value"

13.—(1) Subject to sub-paragraph (5) below, in the case of investments other than land and buildings, current value must mean market value determined in accordance with this paragraph.

(2) In the case of listed investments, market value must mean the value on the balance sheet date or, when the balance sheet date is not a stock exchange trading day, on the last stock exchange trading day before that date.

(3) Where a market exists for unlisted investments, market value must mean the average price at which such investments were traded on the balance sheet date or, when the balance sheet date is not a trading day, on the last trading day before that date.

(4) Where, on the date on which the accounts are drawn up, listed or unlisted investments have been sold or are to be sold within the short term, the value must be reduced by the actual or estimated realisation costs.

(5) Except where the equity method of accounting is applied, all investments other than those referred to in sub-paragraphs (2) and (3) above must be valued on a basis which has prudent regard to the likely realisable value.

14.—(1) In the case of land and buildings, current value must mean the market value on the date of valuation, where relevant reduced as provided in sub-paragraphs (4) and (5) below.

(2) Market value must mean the price at which land and buildings could be sold under private contract between a willing seller and an arm's length buyer on the date of valuation, it being assumed that the property is publicly exposed to the market, that market conditions permit orderly disposal and that a normal period, having regard to the nature of the property, is available for the negotiation of the sale.

(3) The market value must be determined through the separate valuation of each land and buildings item, carried out at least every five years in accordance with generally recognised methods of valuation.

(4) Where the value of any land and buildings item has diminished since the preceding valuation under sub-paragraph (3), an appropriate value adjustment must be made.

(5) The lower value arrived at under sub-paragraph (4) must not be increased in subsequent balance sheets unless such increase results from a new determination or market value arrived at in accordance with subparagraphs (2) and (3).

(6) Where, on the date on which the accounts are drawn up, land and buildings have been sold or are to be sold within the short term, the value arrived at in accordance with sub-paragraphs (2) and (4) must be reduced by the actual or estimated realisation costs.

(7) Where it is impossible to determine the market value of a land and buildings item, the value arrived at on the basis of the principle or purchase price or production cost must be deemed to be its current value.

Application of the depreciation rules

15.—(1) Where:

(a) the value of any asset of a society is determined in accordance with paragraph 10 or 11 above; and

(b) in the case of a determination under paragraph 10 above, the asset falls to be included under Assets item B.I.,

the value must be, or (as the case may require) be the starting point for determining, the amount to be included in respect of that asset in the society's accounts, instead of its cost or any value previously so determined for that asset; and paragraphs 19, 23 and 25 below must apply accordingly in relation to any such asset with the substitution for any reference to its cost of a reference to the value most recently determined for that asset in accordance with paragraph 10 or 11 above (as the case may be).

(2) The amount of any provision for depreciation required in the case of any asset by paragraph 20 or 21 below as it applies by virtue of sub-paragraph (1) is referred to below in this paragraph as the "adjusted amount", and the amount of any provision which would be required by that paragraph in the case of that asset according to the historical cost accounting rules is referred to as the "historical cost amount".

(3) Where sub-paragraph (1) applies in the case of any asset the amount of any provision for depreciation in respect of that asset included in any item shown in the income and expenditure account in respect of amounts written off assets of the description in question may be the historical cost amount instead of the adjusted amount, provided that the amount of any difference between the two is shown separately in the income and expenditure account or in a note to the accounts.

16.—(1) This paragraph applies where the amounts to be included in respect of assets covered by any items shown in a society's accounts have been determined in accordance with paragraph 10 or 11 above.

(2) The items affected and the basis of valuation adopted in determining the amounts of the assets in question in the case of each such item must be disclosed in a note to the accounts.

(3) The purchase price of investments valued in accordance with paragraph 10 above must be disclosed in the notes to the accounts.

(4) In the case of each balance sheet item valued in accordance with paragraph 11 above either:

(a) the comparable amounts determined according to the historical cost accounting rules (without any provision for depreciation or diminution in value); or

(b) the differences between those amounts and the corresponding amounts actually shown in the balance sheet in respect of that item,

must be shown separately in the balance sheet or in a note to the accounts.

(5) In sub-paragraph (4) above, references in relation to any item to the comparable amounts determined as there mentioned are references to:

(a) the aggregate amount which would be required to be shown in respect of that item if the amounts to be included in respect of all the assets covered by that item were determined according to the historical cost accounting rules; and

(b) the aggregate amount of the cumulative provisions for depreciation or diminution in value which would be permitted or required in determining those amounts according to those rules.

Revaluation reserve

17.—(1) Subject to sub-paragraph (6) below, with respect to any determination of the value of an asset of a society in accordance with paragraph 10 or 11 above, the amount of any gain or loss arising from that determination (after allowing, where appropriate, for any provisions for depreciation or diminution in value made otherwise than by reference to the value so determined and any adjustments of any such provisions made in the light of that determination) must be credited or (as the case may be) debited to a separate reserve ("the revaluation reserve").

(2) The amount of the revaluation reserve must be shown in the society's balance sheet under Liabilities item A.I, but need not be shown under the name "revaluation reserve".

(3) An amount may be transferred from the revaluation reserve to the income and expenditure account, if the amount was previously charged to that account and the revaluation reserve must be reduced to the extent that the amounts transferred to it are no longer necessary for the purposes of the valuation method used.

(4) The revaluation reserve must not be reduced except as mentioned in this paragraph.

(5) The treatment for taxation purposes of amounts credited or debited to the revaluation reserve must be disclosed in a note to the accounts.

(6) This paragraph does not apply to the difference between the valuation of investments and their purchase price or previous valuation shown in the long term business technical account or the non-technical account in accordance with note (9) on the income and expenditure account format.

PART IV

HISTORICAL COST ACCOUNTING RULES

Preliminary

18. Subject to paragraphs 8 to 17 above, the amounts to be included in respect of all items shown in a society's accounts must be determined in accordance with the rules set out in paragraphs 19 to 31 below.

Valuation of assets

General rules

19. Subject to any provision for depreciation or diminution in value made in accordance with paragraph 20 or 21 below, the amount to be included in respect of any asset in the balance sheet format must be its cost.

20. In the case of any asset included under Assets item A (intangible assets), B.I (land and buildings), F.I. (tangible assets) or F.II (stocks) which has a limited useful economic life, the amount of:

(a) its cost; or

(b) where it is estimated that any such asset will have a residual value at the end of the period of its useful economic life, its cost less that estimated residual value,

must be reduced by provisions for depreciation calculated to write off that amount systematically over the period of the asset's useful economic life.

21.—(1) This paragraph applies to any asset included under Assets item A (tangible assets), B (investments) or F.I (tangible assets).

(2) Where an asset to which this paragraph applies has diminished in value, provisions for diminution in value may be made in respect of it and the amount to be included in respect of it may

be reduced accordingly; and any such provisions which are not shown in the income and expenditure account must be disclosed (either separately or in aggregate) in a note to the accounts.

(3) Provisions for diminution in value must be made in respect of any asset to which this paragraph applies if the reduction in its value is expected to be permanent (whether its useful economic life is limited or not), and the amount to be included in respect of it must be reduced accordingly; and any such provisions which are not shown in the income and expenditure account must be disclosed (either separately or in aggregate) in a note to the accounts.

(4) Where the reasons for which any provision was made in accordance with subparagraph (1) or (2) have ceased to apply to any extent, that provision must be written back to the extent that it is no longer necessary; and any amounts written back in accordance with this subparagraph which are not shown in the income and expenditure account must be disclosed (either separately or in aggregate) in a note to the accounts.

22.—(1) This paragraph applies to assets included under Assets items E.I., II, and III (debtors) and F.III (cash at bank and in hand) in the balance sheet.

(2) If the net realisable value of an asset to which this paragraph applies is lower than its cost the amount to be included in respect of that asset must be the net realisable value.

(3) Where the reasons for which any provision for diminution in value was made in accordance with sub-paragraph (2) have ceased to apply to any extent, that provision must be written back to the extent that it is no longer necessary.

Development costs

23.—(1) Notwithstanding that amounts representing "development costs" may be included under Assets item A (intangible assets) in the balance sheet format, an amount may only be included in a society's balance sheet in respect of development costs in special circumstances.

(2) If any amount is included in a society's balance sheet in respect of development costs the following information must be given in a note to the accounts:

- (a) the period over which the amount of those costs originally capitalised is being or is to be written off; and
- (b) the reasons for capitalising the development costs in question.

Goodwill

24.—(1) The application of paragraphs 19 to 21 above in relation to goodwill (in any case where goodwill is treated as an asset) is subject to the following provisions of this paragraph.

(2) Subject to sub-paragraph (3) below, the amount of the consideration of any goodwill acquired by a society must be reduced by provisions for depreciation calculated to write off that amount systematically over a period chosen by the committee of management.

(3) The period chosen must not exceed the useful economic life of the goodwill in question.

(4) In any case where any goodwill acquired by a society is included as an asset in the society's balance sheet the period chosen for writing off the consideration for that goodwill and the reasons for choosing that period must be disclosed in a note to the accounts.

PART V

MISCELLANEOUS AND SUPPLEMENTAL

Excess of money owed over value received as an asset item

25.—(1) Where the amount repayable on any debt owed by a society is greater than the value of the consideration received in the transaction giving rise to the debt, the amount of the difference may be treated as an asset.

(2) Where any such amount is so treated:

(a) it must be written off by reasonable amounts each year and must be completely written off before repayments of the debt; and

(b) if the current amount is not shown as a separate item in the society's balance sheet it must be disclosed in a note to the accounts.

Assets included at a fixed amount

26.—(1) Subject to the following sub-paragraph, assets which fall to be included under Assets item F.I. (tangible assets) in the balance sheet format may be included at a fixed quantity and value.

(2) Sub-paragraph (1) applies to assets of a kind which are constantly being replaced, where:

(a) their overall value is not material to assessing the society's state of affairs; and

(b) their quantity, value and composition are not subject to material variation.

Determination of cost

27.—(1) The cost of an asset that has been acquired by the society must be determined by adding to the actual price paid any expenses incidental to its acquisition.

(2) The cost of an asset constructed by the society must be determined by adding to the purchase price of the raw materials and consumables used the amount of the costs incurred by the society which are directly attributable to the construction of that asset.

(3) In addition, there may be included in the cost of an asset constructed by the society:

(a) a reasonable proportion of the costs incurred by the society which are only indirectly attributable to the construction of that asset, but only to the extent that they relate to the period of the construction; and

(b) interest on capital borrowed to finance the construction of that asset, to the extent that it accrues in respect of the period of construction,

provided, however, in a case within sub-paragraph (b) above, that the inclusion of the interest in determining the cost of that asset and the amount of the interest so included is disclosed in a note to the accounts.

28.—(1) Subject to the qualification mentioned below, the cost of any assets which are fungible assets may be determined by the application of any of the methods mentioned in sub-paragraph (2) below in relation to any such assets of the same class.

The method chosen must be one which appears to the committee of management to be appropriate in the circumstances of the society.

(2) Those methods are:

(a) the method known as "first in, first out" (FIFO);

(b) the method known as "last in, first out" (LIFO);

(c) a weighted average price; and

(d) any other method similar to any of the methods mentioned above.

(3) Where in the case of any society:

(a) the cost of assets falling to be included under any item shown in the society's balance sheet has been determined by the application of any method permitted by this paragraph; and

(b) the amount shown in respect of that item differs materially from the relevant alternative amount given below in this paragraph,

the amount of that difference must be disclosed in a note to the accounts.

(4) Subject to sub-paragraph (5) below, for the purposes of sub-paragraph (3)(b) above, the relevant alternative amount, in relation to any item shown in a society's balance sheet, is the amount which would have been shown in respect of that item if assets of any class included under that item at an amount determined by any method permitted by this paragraph had instead been included at their replacement cost as at the balance sheet date.

(5) The relevant alternative amount may be determined by reference to the most recent actual purchase price before the balance sheet date of assets of any class included under the item in question instead of by reference to their replacement cost as at that date, but only if the former appears to the committee of management to constitute the more appropriate standard of comparison in the case of assets of that class.

Substitution of original amount where price or cost unknown

29. Where there is no record of the purchase price of any asset acquired by a society or of any price, expenses or costs relevant for determining its cost in accordance with paragraph 27 above, or any such record cannot be obtained without unreasonable expense or delay, its cost must be taken for the purposes of paragraphs 19 to 24 above to be the value ascribed to it in the earliest available record of its value made on or after its acquisition by the society.

Assets and liabilities denominated in foreign currencies

30.—(1) Subject to the following subparagraphs, amounts to be included in respect of assets and liabilities denominated in foreign currencies must be in sterling after translation at an appropriate spot rate of exchange prevailing at the balance sheet date.

(2) An appropriate rate of exchange prevailing on the date of purchase may however be used for assets held as financial fixed assets and assets to be included under asset items A and F1 in Part I or Part II of Schedule 2, if they are not covered or not specifically covered in either the spot or forward currency markets.

(3) An appropriate spot rate of exchange prevailing at the balance sheet date must be used for translating uncompleted spot exchange transactions.

(4) An appropriate forward rate of exchange prevailing at the balance sheet date must be used for translating uncompleted forward exchange transactions.

(5) This paragraph does not apply to assets or liabilities held, or any transaction entered into, for hedging purposes, or to any assets or liabilities which are themselves hedged.

31.—(1) Subject to subparagraph (2), any difference between the amount to be included in respect of an asset or liability under paragraph 30 and the book value, after translation into sterling at an appropriate rate, of that asset or liability, must be credited or, as the case may be, debited to the income and expenditure account.

(2) In the case however of assets held as financial fixed assets, of assets to be included in asset items A and F1 in Part I or Part II of Schedule 2, and of transactions undertaken to cover such assets,

any such difference must be deducted from or credited to the general reserve included in the balance sheet.

32. The provisions of this Schedule which relate to long term business apply, with necessary modifications, to business within Classes 1 and 2 of Head B of Schedule 2 to the Act which:

(a) is transacted exclusively or principally according to the technical principles of long term business; and

(b) is a significant amount of the business of the society.

PART VI

RULES FOR DETERMINING PROVISIONS

Preliminary

33. Provisions which are to be shown in a society's accounts must be determined in accordance with paragraphs 34 to 40 below.

Technical provisions

34. The amount of technical provisions must at all times be sufficient to cover any liabilities arising out of insurance contracts as far as can reasonably be foreseen.

Provision for unearned premiums

35.—(1) The provision for unearned premiums must in principle be computed separately for each insurance contract, save that statistical methods (and in particular proportional and flat rate methods) may be used where they may be expected to give approximately the same results as individual calculations.

(2) Where the pattern of risk varies over the life of a contract, this must be taken into account in the calculation methods.

Provision for unexpired risks

36. The provision for unexpired risks (as defined in paragraph 10 of Schedule 9 below) must be computed on the basis of claims and administrative expenses likely to arise after the end of the financial year from contracts concluded before that date, in so far as their estimated value exceeds the provision for unearned premiums and any premiums receivable under those contracts.

Long term business provision

37.—(1) The long term business provision must in principle be computed separately for each long term contract, save that statistical or mathematical methods may be used where they may be expected to give approximately the same results as individual calculations.

(2) A summary of the principal assumptions in making the provision under subparagraph (1) must be given in the notes to the accounts.

(3) The computation must be made annually by a Fellow of the Institute or Faculty of Actuaries on the basis of recognised actuarial methods, with due regard to the actuarial principles laid down in the Friendly Societies (Authorisation) Regulations 1994(**1**).

(**1**) S.I. 1994 No. 1982.

Provisions for claims outstanding

General business

38.—(1) A provision must in principle be computed separately for each claim on the basis of the costs still expected to arise, save that statistical methods may be used if they result in an adequate provision having regard to the nature of the risks.

(2) This provision must also allow for claims incurred but not reported by the balance sheet date, the amount of the allowance being determined having regard to past experience as to the number and magnitude of claims reported after previous balance sheet dates.

(3) All claims settlement costs (whether direct or indirect) must be included in the calculation of the provision.

(4) Recoverable amounts arising out of subrogation or salvage must be estimated on a prudent basis and either deducted from the provision for claims outstanding (in which case if the amounts are material they must be shown in the notes to the accounts) or shown as assets.

(5) In sub-paragraph (4) above, "subrogation" means the acquisition of the rights of members or policy holders with respect to third parties, and "salvage" means the acquisition of the legal ownership of insured property.

(6) Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose must be calculated by recognised actuarial methods, and paragraph 40 below must not apply to such calculations.

(7) Implicit discounting or deductions, whether resulting from the placing of a current value on a provision for an outstanding claim which is expected to be settled later at a higher figure or otherwise effected, is prohibited.

39.—(1) Explicit discounting or deductions to take account of investment income is permitted, subject to the following conditions:

(a) the expected average interval between the date for the settlement of claims being discounted and the accounting date must be at least four years;

(b) the discounting or deductions must be effected on a recognised prudential basis;

(c) when calculating the total cost of settling claims, the society must take account of all factors that could cause increases in that cost;

(d) the society must have adequate data at its disposal to construct a reliable model of the rate of claims settlements; and

(e) the rate of interest used for the calculation of present values must not exceed a rate prudently estimated to be earned by assets of the society which are appropriate in magnitude and nature to cover the provisions for claims being discounted during the period necessary for the payment of such claims, and must not exceed either:

(i) a rate justified by the performance of such assets over the preceding five years; or

(ii) a rate justified by the performance of such assets during the year preceding the balance sheet date.

(2) When discounting or effecting deductions, the society must, in the notes to the accounts, disclose:

(a) the total amount of provisions before discounting or deductions,

(b) the categories of claims which are discounted or from which deductions have been made; and

(c) for each category of claims, the methods used, in particular the rates used for the estimates referred to in sub-paragraphs (1)(d) and (e), and the criteria adopted for estimating the period that will elapse before the claims are settled.

Long term business

40. The amount of the provision for claims must be equal to the sums due to beneficiaries, plus the costs of settling claims.