Association of British Insurers

Louder than Words

The ABI's Response to the FRC's discussion paper

Introduction

1. The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters. They have a strong interest both as users and as preparers of accounts in effective corporate reporting, the avoidance of undue complexity and a focus on relevance to ensure that communication between companies and their shareholders and other investors is made as good as it can be.

2. We welcome the FRC's initiative in publishing this discussion paper as enhancing relevance and reducing complexity are key objectives which need to be energetically pursued in order to combat the natural tendency for movement in the opposite direction to result. The discussion paper itself is written in a refreshing way and we hope this will enthuse action in pursuit of its worthy goals, challenging as this in practice may be. Investors would like to see progress made.

General Comments

3. We welcome the acknowledgement (pages 5, 10) that corporate reports are aimed currently at too many types of user and need to be refocused on their primary purpose: providing investors with information that is useful in their decision making and assessing management's stewardship. It would have been helpful if that message had come through far more explicitly in the FRC's guiding principles and related calls for action. Indeed it would have been better if the FRC were less tied by the language used by the IASB and to identify more clearly that the current shareholders should be recognised as the primary audience for corporate reporting purposes. We would add that annual reports should not be used for reporting to regulators for solvency purposes, although of course they are appropriate for reporting to investors on the effects of regulation

4. The principles on pages 16 and 17 focus on regulators and regulation. Yet companies may themselves create undue complexity and not being relevant enough in their reporting. Hence, many of these messages are for them as well. This need is underscored by the recognition on page 20 that IFRS7 disclosures have not helped users as much as they should have done because preparers, in many cases, may have aimed only to do as little as possible to meet minimum requirements.

5. We strongly support the ‘call for action one’ on page 21 to improve cash flow and net debt reporting and agree with the need to enable reconciliation in the movement of net debt.

6. We are somewhat surprised by the assertion that most users do not consider valuation of intangible assets acquired as part of a business combination useful (page 23). Of course decisions to make acquisitions can be made on the basis of various valuation metrics for the business, indeed the frequent creation of purchased goodwill demonstrates this, but this does not mean that users are uninterested in the division of the excess of purchase price over net tangible assets between intangibles and goodwill. It is right for stewardship purposes that such information should be made available.

7. ‘Call for action two’ on page 24, to ensure disclosure requirements are relevant and proportionate to risks and to encourage a project to investigate the characteristics of useful disclosures is one we would support though we are not sure what organisation ‘could constructively kick off this work’. If one does not come to light the FRC might like to consider undertaking this itself.

8. Although supportive of ‘call to action three’, to ensure requirements for wholly-owned subsidiaries’ reporting are targeted and proportionate, we would suggest caution in believing that significant reductions in reporting would be appropriate. Even if it were thought that investors were not interested in such accounts (and we do not believe that to be the case) creditors’ information needs also require respect.

9. We agree with the cautionary note sounded on page 27 about not pursuing regulatory convergence for its own sake. The desire of investors for consistency and comparability in accounting makes convergence a worthwhile goal though achieving this does come at a price in that it significantly reduces the scope for regulatory competition which can provide worthwhile benefits.

10. The recommendation on page 31 that the desired outcome of accounting standards should be clearly expressed is helpful. We consider that the more recent standards promulgated by the IASB do better in this regard than some of the earlier IASs. Where old ones have been amended more recently, ‘desired outcome’ information is given for the amendment. Incremental progress is therefore being made and it would be unlikely to be cost-effective for the older standards to be revamped to address this concern.

11. The criticism of IFRS 8 does not seem correctly directed. The principle places the focus on the user, which is entirely right. The approach, ‘Through the eyes of management’ has been selected as a means of achieving this. Many investors in any case have reservations about the use of this approach, and indeed the rationale expounded in the IASB’s 2006 press release that the discussion paper cites, and we certainly do not wish to see it viewed as a principle in itself.

12. It is suggested on page 33 that IFRS 2 is a particularly rules-based standard. However, we feel that the specification of the standard does reflect an aim to

capture the essence of underlying economic reality which must be the correct primary objective. We suspect that concerns in respect of this standard come more from preparers than users.

13. The various objectives of writing in plain language, using consistent terminology, adopting easy-to-follow structures, as addressed on pages 35 and 36 are of course worthy and we do agree that IASB standards have not been always been as 'accessible' as they might have been. The IASB might also usefully consider whether difficulties have been caused in this regard as part of their post-implementation reviews of new standards.

14. We agree action point on page 45 which seeks to avoid immaterial disclosures being made. It is disappointing if, as the discussion paper appears to suggest, that such disclosures any result from a disinclination on the part of management to engage with audit committees. These committees, for their part, also need to be able to make appropriate judgments on matters that are brought to their attention. As the discussion paper notes, avoidance of fraud is a key reason why auditing cannot work only at the level of what is quantitatively material. This is very much a matter of ensuring effective governance of companies and effective engagement with and by the audit committee is essential.

ANNEX

Questions for Consultation

---

1 Can the principles for less complex regulation we propose help reduce complexity? Are there other principles that should be considered?

Yes, though they would be even better were they to identify that the interests of shareholders are of primary significance.

2 Targeted: Is cash flow reporting in need of improvement? If so, what is the best means of achieving this improvement? Consider changes to IFRS, best practice guidance, publicity campaigns, other.

Yes, and we think the summary of views as presented in the discussion paper is a fair reflection of users' concerns. The IASB needs to address these.

3 Proportionate: Should accounting standards and other regulations be based more on the information that management produces internally?

No, we do not think this would be the right way to proceed. The standards should be focused on the information needs and expectations of users. A proper recognition of the stewardship perspective in financial reporting makes clear the potential dangers of companies being run on a basis that does not accord with their owners' assessment of the financial performance and position of the company. In these circumstances it is particularly important that information is provided on a basis that accords with a standard to which other companies comply.

4 Proportionate: Would a project on disclosures help stem the constant growth of accounting disclosure requirements? Could it also identify the most important disclosures, with a view to giving them greater prominence?

Yes.

5 Targeted and proportionate: Who are the main users of wholly-owned subsidiary accounts? Should subsidiaries be required to file audited accounts with full disclosures? Is a more simplified reporting regime more appropriate?

The primary user of a wholly-owned subsidiary's accounts should be considered to be the directors of the parent company who are responsible in turn to the shareholders of the parent company for their oversight of the subsidiary. We emphasise it is the directors, not the management, of the parent company who are responsible in this regard and that it is not sufficient to assert that management relies on management accounts of the subsidiary. In practice creditors as well as investors in the parent company are users of subsidiary accounts.

We are not sure whether there is worthwhile scope to reduce disclosure requirements for wholly-owned subsidiaries. For investors in the parent who use subsidiary accounts it is particularly likely to be disclosures rather than figures in the primary financial statements that will be of interest to them.

6 Targeted and proportionate: Would it be desirable to eliminate the UK requirement to prepare, have audited, and file wholly-owned subsidiary accounts in the case of a parent company guarantee?

No, we do not consider this right. The provision of guarantees by the parent increases rather than reduces the risks to the parent company and its shareholders and therefore the interest shareholders of the parent may themselves have in referring to subsidiary accounts and taking comfort in the audit thereof. Even more pertinently, it makes it more important that the board of the parent company has access to the audited accounts of the subsidiary in question.

If this concept were to be taken forward for further consideration we feel it could only be contemplated for genuinely small subsidiaries where the materiality for parent company and its shareholders would be very low.

7 Coordinated: Would it increase or decrease complexity if national and international regulators worked together in a more joined-up way? Is there a risk that international regulators working together might result in imported complexity for some jurisdictions? How do we mitigate this risk?

This seems to be a worthy aspiration though we are not sure that there is a great deal that can practically be achieved.

8 Clear: Would an emphasis on delivering regulations and accounting standards in a clear, understandable way reduce complexity? How can we best move towards clearer regulations and accounting standards?

Again, this is a worthy aspiration.

9 Do you agree that principles for effective communication can reduce complexity in corporate reporting?

Again, this is a worthy aspiration.

10 What are the barriers to more effective communication? How might these barriers be overcome?

We believe that best practical means to achieve this is through fostering a culture of openness and transparency. In practice this will be particularly applicable in the area of narrative reporting. We welcome the publication by the IASB of its Management Commentary exposure draft and the opportunity this will provide for further enhancement in this area.

11 Which of the specific sources of complexity in corporate reports noted on pages 54 to 55 warrant further action? Which organisation(s) would be best placed to assist with the necessary action?

We think there is a fairly clear consensus between users and preparers of accounts that progress can be made in the area of hedge accounting. We agree that better segmental reporting of cash-flows would be helpful to users.

In a number of the other areas mentioned, such as financial instrument and defined benefit pension accounting and, indeed, in fair value accounting generally, there will be limits to how much complexity can really be reduced while ensuring the right accounting treatment on the face of the accounts and the provision of such additional information as users legitimately require. We have commented earlier on our reservations as to the scope for reduction in complexity in respect of share-based payment.

For users interpretive guidance is not a source of complexity of such, and its value is in the first instance for preparers but also should tend to enhance consistency which will obviously be helpful to users. If preparers find the guidance unhelpful it needs to be revised but users of accounts would probably resist its removal.

A number of the areas mentioned, such as CSR and remuneration reporting are not, at heart, core elements of financial reporting and probably need to be viewed separately from a core project to reduce complexity. Remuneration reporting in the UK is an emanation largely of company law.