Association of British Insurers

Policy Proposal: The Future of UK GAAP

The ABI's response to the ASB's consultation paper

Introduction

1. The ABI is the voice of the insurance and investment industry in the UK. 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.

2. The ABI is grateful to the *Accounting Standards Board (ASB)* for the opportunity to respond to its invitation to comment on its consultation paper, *Policy Proposal: The Future of UK GAAP.*

ABI comments

3. We acknowledge that the current state of affairs should not persist indefinitely whereby the ASB's standards are variably consistent or inconsistent with IFRSs, without any real underlying rationale. We therefore welcome the ASB's initiative in seeking to put UK GAAP on a firmer footing. We note the attractions of simplicity in its proposals, in that the IASB's standards would apply to all except those small companies who elect for the FRSSE. We can see some scope for long-term efficiency savings, though against these must be set the inevitable short term, but potentially significant, transitional costs.

4. However, important though they are, these are mostly input criteria relating to the standard setting process. The key consideration must instead be what benefits most the user of accounts, as set against the cost to the preparer. From that perspective we question some of the ASB's proposals, and we suggest that it should explore further alternatives. In any case, we regard the ASB's proposed timetable as being unrealistic.

5. We regard it as axiomatic that the interests of international suppliers of capital are best served by accounts that meet uniform international requirements. In other contexts, it is not so clear that such uniformity is an absolute benefit. The cost/benefit balance may be different for national suppliers of capital who may be content with, or even prefer, national requirements.

6. Further, we note that UK company law emphasises the importance of stewardship and accountability in the role of accounting standards rather more than does the IASB in its much greater focus on investors' economic decision making. These factors point to a continuing need for a UK setter of accounting standards, even if

the ASB were to use the IASB's standards as its template – and this eventuality does not, we should point out, constitute the abolition of UK GAAP. This is because company law requirements still remain.

7. We think it sensible that IFRSs are used as the starting point for UK standards. This ensures that there is maximum consistency of accounts of listed companies, so important to the UK economy, and those complying with any UK standards. Furthermore, it ensures that any departure from IFRSs is clearly identified, justified, and accepted by users and by other constituents. Lastly, we find the IFRS for SMEs attractive as a considerable simplification of full IFRSs for appropriate companies, though further adjustments may be welcome in the UK context.

8. Accordingly, we consider that, as a minimum, the following should be taken into account in the further development of the ASB's proposals:

   - *Scope*: We do not consider that all publically accountable entities need to have the same accounting requirements. We agree that public accountability should prevent a small entity from adopting the FRSSE. But we do not think that it should prevent a non-listed entity from applying the IFRS for SMEs;

   - *Wholly-owned subsidiaries*: We do not agree that entities need have the same accounting requirements whether they are wholly owned subsidiaries or not. We propose that the ASB carry out a full review of the appropriateness of IFRS standards for UK subsidiaries of UK parents. This review should consider the relevance and costs and benefits of the IFRS standards for wholly owned subsidiaries irrespective of whether or not such subsidiaries fall into the SME definition. Such a review should, for example, consider the relevance of preparing cash flow statements for such subsidiaries. The findings of that review should be considered at a granular level with the draft findings aired in a consultation document so that preparers and users have the chance to comment;

   - *Impact on tax, distributable reserves and banking covenants*: We consider that a significant reason why many UK entities, whether members of listed groups or not, have not moved to IFRS is the potential effect on their tax affairs and on their distributable reserves. Entities may also be aware of the effect of agreements such as banking covenants, and perhaps remuneration packages. We suggest that the ASB needs to undertake more research into these potential consequences of removing its accounting standards and of moves to full IFRS or the IFRS for SMEs;

   - *Impact on the insurance SORP*: The IASB's project to replace the currently inadequate IFRS 4, Insurance Contracts, will have a significant impact in due course. But the new insurance accounting standard may not be in place in 2012, and may not be a requirement until 2013 or later. These developments will need to be monitored, but it would be premature for the ASB's standards to be switched off without a plan to cover any gap. We will need to work together with the ASB accordingly.

9. We emphasise that, in any case, the ASB's proposed timetable is premature. The experience of listed companies adopting IFRSs in 2005 shows that more time is required to make the change from UK standards.

10. We note that, notwithstanding the radical nature of its proposals, the ASB does not intend to give up its UK standard setting role or capacity. We take the opportunity of supporting the ASB in this respect. Indeed, we urge caution in making too radical assumptions at this time about the future of UK GAAP. There is significant uncertainty about IFRS/US GAAP convergence and the possible emergence of European accounting standard setting.

11. We expand on these comments, and set out others, in the annex to this letter. We would be happy to discuss them further with you.

Association of British Insurers
February 2010

ANNEX

Questions for consultation

***Question 1** – Which definition of Public Accountability do you prefer: the Board's proposal (paragraph 2.3) or the current legal definitions (paragraph 2.5)? Please state the reasons for your preference. If you do not agree with either definition, please explain why not and what your proposed alternative would be?*

1. We prefer the Board's proposal. We do not consider that the definition should cover all public companies, nor all insurance activity, nor yet all companies in a group in which there is a company that has public accountability.

***Question 2** – Do you agree that all entities that are publicly accountable should be included in Tier 1? If not, why not?*

2. We do not share the IASB's or the ASB's presumption that all users of accounts of publically accountable entities have the same requirements. The interests of the user of accounts of a listed entity are not necessarily the same as those of an entity which takes deposits or holds assets in a fiduciary capacity.

3. For example, we do not think that purchasers of insurance policies, who may supply much of insurance companies' capital needs, should be assumed to make their purchases on the basis of their evaluation of the insurer's accounts. Indeed, the regulatory regime in the UK, by guaranteeing most of the policyholder's interest, makes this evaluation largely unnecessary. Because policyholders' economic decisions are not based on accounts, so those accounts need not give the same information as do full IFRS-based accounts on which investors in listed companies rely. Further, the regulators of insurance companies do not rely wholly on insurers' accounts. Regulators are able to require much supplementary information, and they do so.

4. Mutual insurers exemplify this point, and even more so do those with closed books. They are not profit making entities for the benefit of shareholders generally. They act in the interests of their policyholders, to whom any surplus is distributed. Their policyholders' interests vary with the terms of their policies, and by far the most important factor in policyholders' decisions to buy or not to do so, and to remain or transfer out, is specific policy performance rather than general entity performance. We also consider that similar considerations apply to institutions such as friendly societies and credit unions.

5. We conclude that it should be possible for non-listed publically accountable entities to be able to use the IFRS for SMEs. We nevertheless agree that they should not be able to use the FRSSE.

***Question 3** – Do you agree with the Board's proposal that wholly-owned subsidiaries that are publicly accountable should apply EU adopted IFRS? If not, why not?*

6. We consider that a holding company has sufficient access to information as not to rely on its subsidiaries' accounts, whether the subsidiaries are publically accountable or not. Further, as above, we do not agree that the other principle

stakeholders (in the case of insurers, their policyholders and regulators) should be assumed to rely on insurers' accounts to make economic decisions in the same way as do investors in listed companies.

7. Accordingly, we do not agree that wholly-owned subsidiaries (or subsidiaries with insignificant minority interests) that are publically accountable should apply EU adopted IFRSs. We consider they should instead be able to use IFRSs, including the IFRS for SMEs as an option, with reduced disclosures. We nevertheless think that they should not be able to use the FRSSE.

8. We suggest that the ASB should undertake a full review of IFRS's 3,000 disclosure requirements, and the IFRS for SMEs 300 (see our answer to question 6 below), to evaluate which are relevant to wholly-owned subsidiaries (or subsidiaries with insignificant minority interests) and which are not. We consider that reduced disclosures in this context need not be incompatible with the true and fair view. Such a review should also cover the possibilities, which we would support, that cash flow statements should not always be required

9. We consider that having this approach should be applied to both full IFRSs and to IFRS for SMEs because groups may not want to apply the IFRS for SME's different measurement requirements in their subsidiaries – for example, for goodwill, intangibles, deferred tax and property assets. We note that this approach adds complexity to the ASB's regime. However we consider that the extra cost of maintaining a more complex regime cost may be outweighed by the benefits to groups that do not want to maintain two sets of books.

***Question 4** – Do you still consider that wholly-owned subsidiaries that are publicly accountable should be allowed reduced disclosures? If so, it would be helpful if you could highlight such disclosure reductions as well as explaining the rationale for these reductions.*

10. As above, we consider that wholly-owned subsidiaries that are publically accountable should be allowed reduced disclosures. We support a full review by the ASB for this purpose.

***Question 5** – Do you agree with the Board's proposal that the IFRS for SMEs should be used by 'Tier 2' entities?*

11. We agree, although of course they should also be able to use full IFRSs.

***Question 6** – Do you agree with the Board's proposal that the IFRS for SMEs should be adopted wholesale and not amended? If not, why not? It would be helpful if you could provide specific examples of any amendments that should be made, as well as the reason for recommending these amendments.*

12. Consistent with our answer to question 3 above, we think that the interests of users of accounts of wholly-owned subsidiaries (or subsidiaries with insignificant minority interests) are not the same as users of other accounts. Holding companies are able to access whatever information is appropriate irrespective of the content of the financial statements. The case to answer is what other users of the statements would benefit by full compliance with IFRS requirements, particularly over cash flow statements and some of the IFRS disclosure requirements. Other suppliers of capital can normally obtain the information they

need on a transaction basis. And subsidiaries will no doubt respond to market pressures that call for full IFRS based accounts on an on-going basis. We consider that the ASB should review the potential for reducing the accounting and disclosure requirements of the IFRS for SMEs in the case of wholly-owned subsidiaries (or subsidiaries with insignificant minority interests). We do not think that this need impair a true and fair view – the ASB's standards already recognise the need for subsidiaries to be treated differently.

13. A prime example is that we do not think that cash-flow statements need be required for wholly owned subsidiaries (or subsidiaries with insignificant minority interests). And we consider that cash flow statements are in any case less relevant to insurers. In that context, we note that the ASB's FRS 1 acknowledges that a standard cash flow statement of an insurance company is less helpful to the user of accounts and that FRS 1's scope excludes mutual life assurance companies.

14. We also note that that a significant reason why many UK entities, whether members of listed groups or not, have not moved to IFRS is the potential effect on their tax affairs and on their distributable reserves. Naturally, the IASB does not consider such national characteristics in the development of its standards. But they are clearly important to national stakeholders – and are clearly informing decisions in other European countries to retain their national GAAP to varying degrees and in some cases quite substantially. We suggest that the ASB needs to undertake more research into the potential consequences of adopting IFRSs for SMEs in place of the ASB's current standards.

Question 7 *– Do you agree with the Board's proposal that large Non-Publicly Accountable Entities should be permitted to adopt the IFRS for SMEs? Or do you agree that large entities should be required to use EU adopted IFRS? Please give reasons for your view.*

15. We agree that large Non-Publically Accountable Entities should be permitted to adopt the IFRS for SMEs. We acknowledge that there may be circumstances in which the interests of the user of such entities' accounts may be better served by full IFRS based accounts. However, we consider that market pressures would be likely to produce this result in any case. And suppliers of capital would often be able to obtain on a transaction basis such extra information that full IFRSs-based accounts would provide. Where relevant, regulators normally also have powers to require this information on an ongoing basis, separately from the accounts.

Question 8 *– Do you agree with the Board that the FRSSE should remain in force for the foreseeable future?*

16. We agree.

Question 9 *– Do you agree that the FRSSE could be replaced by the IFRS for SMEs after an appropriate transition period, following the issuance of the IFRS for SMEs?*

17. We would not exclude the possibility at this stage. However, we consider that further consultation and impact assessment will be required.

Question 10 *– Do you agree with the Board's current views on the future role of SORPs. If not, why not?*

18. We agree that the future of the ABI's insurance SORP is linked to the development of the IASB's Phase 2 project for insurance contracts. The ASB's standards currently underpin the SORP. Without them, and should the IASB not develop its replacement of IFRS 4 in time 2012, there would be a gap in the UK accounting framework. We would need to work with the ASB in the light of this possibility.

19. However, as investors in investment companies we consider that the SORP for that sector should be retained for the time being. The SORP has materially helped improve the industry's financial reporting, to the benefit of shareholders and other stakeholders. And, whilst UK accounting standards still exist, we do not think it appropriate for the ASB to insist that investment companies use IFRSs.

Question 11 – *Do you agree with the Board's proposal to develop a public benefit entity standard as part of its plans for the future of UK GAAP? If not, how should (converged) UK GAAP address public benefit entity issues?*

20. We have no views on this proposal.

Question 12 *– If you do agree with the proposal to develop a public benefit entity standard, should the standard cover all the requirements for preparing true and fair view accounts or should it cover only those issues where IFRS or the IFRS for SMEs needs to be supplemented for the public benefit entity sector?*

21. We have no views on this proposal.

Question 13 – *Do you agree the issues listed in the above table are distinctive for the public benefit entity sector and should therefore be covered in a public benefit entity standard? What other issues might the proposed standard include?*

22. We have no views on this proposal.

Question 14 *– The Board accepts there may be a continuing need for guidance to supplement a public benefit entity standard in sectors such as charities, housing and education. Where this is the case, do you think the Board should provide a Statement confirming the guidance is consistent with UK GAAP, including the public benefit entity standard?*

23. We have no views on this proposal.

Question 15 *– If you are an entity whose basis of preparing financial statements will change under these proposals, what are the likely effects of applying those new requirements? Please indicate both benefits and costs and other effects as appropriate. If you are a user of financial statements (such as an investor or creditor) what positive and negative effects do you anticipate from the implementation of the proposals set out in this paper?*

24. N/A – as we are a trade organisation.

Question 16 – What are your views on the proposed adoption dates?

25. We consider that the ASB's proposed timetable is premature. Under its proposals, many companies would apply the IFRSs for the first time in 2012, but they would not know until some time into 2011 at the earliest what the new framework and associated requirements would be. Yet, for example, comparative would be required – wit, for an entity with a December year-end, a restated opening balance sheet as at 1 January 2011. The experience of listeds applying IFRSs for the first time in 2005 shows that entities may need longer to prepare than that. Nevertheless, the ASB might consider further whether entities should be allowed to early adopt IFRS for SMEs should they choose to do so.

26. The IASB plans to issue a new standard for insurance contracts by mid 2011. But, because listed insurers will need time for the transition from IFRS 4 to the new IFRS, application of the new standard is unlikely to be mandatory before 2013 – at the same time as the new IFRS for financial instruments. Accordingly, we suggest that 2013 should be the very earliest possible date for removing the ASB's standards. The ASB needs anyway to plan for delay in the IASB's Insurance contracts Phase 2 insurance contracts project.