The reluctant regulator

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IN HIS FIVE YEARS AS HEAD OF THE FINANCIAL REPORTING COUNCIL, PAUL BOYLE HAS REFUSED TO BE PANICKED INTO THROWING EVER MORE REGULATION AT THE FALL-OUT FROM ENRON AND THE BIGGEST ECONOMIC CRISIS SINCE THE 1930S, AS HE TELLS **GRAHAM BUCK**.

After five years in the spotlight at the Financial Reporting Council (FRC), Paul Boyle is looking forward to returning to the commercial world in what he describes as the fourth stage of his career.

He was appointed the FRC's first chief executive in 2004, when the then accountancy watchdog added the role of regulating statutory audit and overseeing the professional accountancy bodies. The position was created as the government undertook a review of the lessons for the UK of the Enron and WorldCom accounting scandals. The regulatory regime for UK accounting and auditing was tightened as a review concluded that auditing should be independently regulated. The FRC's role, and the complexity of the work it undertook, expanded as a result.

Boyle says he moved into the regulatory sector almost by accident. The first stage of his career was at Coopers & Lybrand, where he qualified as an accountant and had auditing and consulting experience that included a two-year stint in Turkey.

He followed that up with a decade in industry, including two years at retailer WH Smith and eight years at Cadbury Schweppes. The latter period included work as group financial controller, followed by the post of director of Cadbury with responsibility for finance, IT, purchasing and cocoa buying.

His next move was to the Financial Services Authority in October 1998 as the financial watchdog's first finance director. Boyle says that initially his aim was to bring a commercial focus to the management of the FSA's costs, but the role expanded steadily and he subsequently took over the role of chief operating officer.

When Boyle took on the FRC job in 2004, the remit was to make the council "more than the sum of its various parts, so become more of a coherent organisation". Its responsibilities were now linked together: the overseeing of auditing and accounting, the professionalism of accountants, and good standards of corporate governance through the Combined Code. The FRC's own description of its role is as "the UK's independent regulator responsible for promoting confidence in corporate reporting and governance".

The following year the government decided there should be independent oversight of the actuarial profession, following the collapse of life assurance company Equitable Life.

The steady expansion of the FRC's duties, which Boyle stresses has only ever occurred after lengthy discussions with the government, has been accompanied by an increase in its workforce. In the years immediately after it was set up in 1990, it had no more than 17 or 18 staff; today there are 90. The new systems and procedures meant that its premises at Holborn Hall, in London's Grays Inn Road, was no longer fit for purpose. After a brief, unsatisfactory period operating from more than one site, the FRC decamped to nearby Aldwych House, which was able to accommodate the expanded headcount.

FINEST HOURS As he approaches the end of his tenure, what does Boyle regard as the highlights of his five years?

"We've dealt with so many issues over the period that it's hard to single out any in particular," he replies. "Perhaps what I'm most proud of are the things that the FRC has helped to avoid." As a prime example he cites the introduction in the US of the Sarbanes-Oxley Act in 2004, which marked a dramatic contrast to the UK, where the principles of the Combined Code and the Turnbull Guidance still applied. The FRC undertook a review of Turnbull to decide whether a similar toughening up was appropriate and concluded it wasn't: "a view that appears to have been vindicated", says Boyle.

Back in 2004, British companies were still reporting on UK generally accepted accounting principles (GAAP) and he regards the FRC as overseeing a "fairly smooth" transition to international financial reporting standards (IFRS), even if some important IFRS issues have yet to be resolved.

However, auditing has had the shadow of the EU Audit Directive hanging over it for the past three years. Sarbanes-Oxley introduced the concept of independent regulation of the auditors of all US-listed companies, irrespective of which country they were based in. Boyle says: "For many European countries, the legislation is of limited consequence, but it threatens to have a major impact on London's status as a major global financial centre as overseas auditors will need to be regulated."

Transitional measures introduced by the EU have had some success in softening the impact of the directive, but they expire in 2010.

"We've also made a start on the issue of choice in the audit market. If you only have four major auditing firms there is a risk to the system in the event that one of them goes under," he adds. "The lesson of the financial crisis, as demonstrated by the demise of Bear Stearns and Lehman Brothers, is that large and well-respected companies can disappear almost overnight."

The extension of the FRC's responsibilities has seen it establish the Board for Actuarial Standards as a standard-setting body for actuaries. Meeting these standards is important as the actuarial role involves making assumptions, but these assumptions may not always be correct, Boyle points out.

Most recently, the FRC has returned to the Combined Code and

the possible need to update it. Having launched a consultation in March, a progress report on its review was issued in late July, only days after Sir David Walker unveiled his own preliminary findings on the governance of financial institutions. The FRC's own review, which addresses the entire corporate sector, now goes to a second consultation. Both the FRC and Walker will publish their final reviews towards the end of this year.

CAT AMONG THE PENSION PIGEONS Boyle joined the ACT advisory board in September 2005, and was recently renewed as a board member for another four-year term. His speech at this year's ACT Pensions Conference, at which he addressed the major deficiencies of pension accounting, caused a stir. The point he aimed to get across was that anyone wishing to understand a pension scheme should look much more at the cashflow than is typically the case and rather less at the discounted value of liabilities.

"The latter is rather like looking at a telescope from the wrong end," he suggests. "It effectively makes big objects look smaller and when it's your job as a trustee to ensure that pension payments are made on schedule, this view can be misleading. The challenge is how do you compare a fixed quantum of assets against amounts that will have to be paid out in 60, 80 or even 100 years' time?"

He reminded his audience that as corporate treasurers are skilled at reviewing cashflow, the issue of tackling the rules for pension funds offers them an opportunity to strengthen their hand.

He attempts to bring the lessons learned from his periods as an auditor and a commercial finance manager, as well as his time at the FSA and FRC, in addressing the issue of creative accounting. Despite his concerns, his assessment is fairly upbeat.

"The conditions that existed last September when Lehman Brothers collapsed were terrible. Yet nearly one year later there have been only a limited number of cases of corporate collapse," he notes. "It's no accident that the number of casualties has remained relatively low. I'd like to think that some of the FRC's work has contributed to helping improve the quality of corporate governance."

TIME TO MOVE ON In May the FRC named Stephen Haddrill, director general of the Association of British Insurers, as Boyle's successor when he steps down as chief executive in November.

Boyle says he volunteered to stand down as he felt it was time for a change at the top and to hand over "a high-profile role with a wide range of responsibilities". He cites Gordon Brown's old joke about chancellors whose careers end in failure and those who get out in time. "I am looking to make a seamless transition to Stephen," he adds.

He anticipates a danger of "regulatory overkill" over the next few years, although he also believes that the skills and professionalism of market practitioners will largely determine the course of regulation.

"I'd describe myself as a reluctant regulator; indeed, much of the FRC's work has aimed at discouraging extra regulation rather than developing it," he stresses. "People often imagine the regulator to be a bureaucracy that constantly wants to dream up new rules. It's very far from the truth. We want boards and actuaries to do a good job and, as far as possible, to get it right the first time."

To give an example, in 2008 the FRC's Financial Reporting Review Panel looked at the ways companies account for the impairment of goodwill. The review resulted from recognition that goodwill relating to many acquisition deals carried out when the M&A market was at its peak might have to be written off.

After the panel published its study it wrote to 30 companies, advising them that it intended to review the way goodwill had been accounted for in the report and accounts.

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"When we subsequently checked their accounts, the quality of accounting disclosures had noticeably improved from the previous year," says Boyle. "So the review acted as an incentive for them to improve. It's rather like a referee at a rugby match warning in advance that he will look keenly at players' discipline in the line-out and motivating them to follow the rules.

"This same theme runs throughout our work. Audit inspection aims not to catch out bad examples but rather to encourage firms to do a better job in future years."

In response to the greater emphasis on disclosure of risk introduced by IFRS, he also wants to see treasurers engage more in risk management and the way in which risk management procedure is described in the annual report.

"We'd like improved disclosure by companies of their business models, with clarity on how the company makes its money," he adds. "It's debatable whether all boards have been able to properly recognise their risk models in the past. Treasurers are well placed to provide an objective input into these discussions."

Boyle cites the most sensitive issue of the past year – one that will continue to occupy the FRC – as that of going concern and whether a company actually has the funds in place to continue doing business. As he observes, the greatest risk is that a company runs out of cash just at the moment it is emerging from recession.

He also believes it would be prudent for most companies to plan for several years of only modest economic growth.

"The severity of the downturn will ease, but there is a legacy of huge borrowing right across the economy and massive public sector deficits," he warns. "There is a real risk that both will have a dampening effect on the economy for some time to come."

Another concern is the suggestion from some commentators that accounting has contributed to the economic crisis by exacerbating swings in the economic cycle. Boyle is alarmed by calls for the purpose of accounting to change, so that it is no longer a measurement device but part of measures by which extremes in the economic cycle are smoothed out.

"This is a very dangerous concept. It's inevitable than when the general economy is doing badly companies will report lower profits and even losses. But some claim this is pro-cyclical and that accounting should be adjusted to smooth the cycle.

"Yet you could make a similar claim for house prices. When they are on an upward trend, people are encouraged to buy; when they are falling, people hold off. This serves to intensify the cycle, but that is no reason for attempting to doctor the figures. To whom would we entrust the task of carrying out the doctoring?

"Arguments that encourage the doctoring of accounting are equally dangerous. And if you are a treasurer endeavouring to raise funds, it will be of little help if investors suspect that the figures are doctored."

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