Comment on

“The Financial Reporting Council

International accounting standards and the true and fair view.”

Martin Moore 2 Oct 2013.

(references are to the paragraphs used by Moore)

General:

The central conclusion we draw from this paper[1] is that the fact that the Financial Reporting Council (FRC) thought that it was needed and that it reaches very different conclusions to Bompas together confirm that there is serious uncertainty in this area of law. That must be unsatisfactory and indicates the need for further action to eliminate that uncertainty. However there are a number of points made by Moore which deserve comment.

<u>The principal legal considerations</u>

6 Moore confirms that the requirement of S393(1) (UK Companies Act 2006)for a true and fair view is overarching and applies to individual accounts drawn up under <u>both</u> the Companies Act accounting rules and the International Accounting Standards (IAS)rules. Sub section (1) (b) makes it clear that the Section also applies to group accounts, for which IFRS are in “certain cases” to be used.[2] This seems to make his paragraph 7 superfluous.

9 and 10. Moore quotes from Recital 9 and Article 3(2) of the EU’s IAS Regulation. These require certain tests to be passed before an IAS can be adopted by the EU. These are:

A: A true and fair view. Moore emphasises an apparent capacity allowed to attain this view without “implying a strict conformity with each and every provision of those Directives.”[3]

B: The standard is to be conducive to the public good, and

C: the understandability, relevance, reliability and comparability needed for making economic decisions and assessing the stewardship of management.

He does not quote from the 2013 Directive, which, amongst other things, requires, as did its predecessors, in Recital 9 that the accounts shall be drawn up on a “prudent basis”.

11 Moore refers to the adoption of IAS as being “compliant with these criteria”. He refers to the ARC[4] (Accounting Regulatory Committee :Part of the EU process for approving the

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[1] Oddly it Is not said to be an Opinion.

[2] His footnote 2

[3] These were the 4th and 7th Directives now superseded by the Accounting directive (2013/34/EU).

adoption of IFRS) which, in practice has, at least until very recently, been largely inactive. He does not address here the question of whether the adopted IAS resulted in accounts being drawn up on the required "prudent basis". The IASB has conceded that IFRS39 was inadequate and has now drawn up an exposure draft to address its limitations. The key limitation being addressed is that certain financial instruments were not valued on an adequately prudent basis. IFRS 39 was adopted by the EU and thus it is difficult to see how this standard complied with the requirements of the EU Directives. One therefore has to question the effectiveness of the EU approval processes.

12 and 13. Moore here states that "fair presentation" [5]is the end. He then argues that accounts prepared in accordance with IFRS can be approved as giving a true and fair view. By implication "fair presentation" and a true and fair view are the same but the truth of this assertion is not here supported by any argument. IFRS discount or discard prudence but the accounts are required to be drawn up on a "prudent basis and should give a true and fair view"[6].

It therefore appears that his assertion that IFRS accounts give a true and fair view cannot stand.

16 and 17. These take as given the unsupported assumption that "fair presentation" is the same as true and fair.

18 IAS1 envisages the possibility of a failure to achieve its own objective of " fair presentation" if compliance with a standard "does not represent faithfully the transaction…". We are not aware of any accounts which used this override to achieve " fair presentation" (at this point ignoring true and fair) even though it is now admitted that IFRS 39 was "inadequate". Presumably therefore transactions have not been faithfully represented.

Thus even if Moore were to be correct in equating true and fair with " faithful representation" in this respect, at least, IFRS have not resulted in a true and fair view.

19 Moore correctly states that IAS 1 refers to the Framework and not the Conceptual Framework adopted in 2010 by IASB. His conclusion that there "is no necessary tension between s 393[True and fair view] and S 397[IAS accounts]" does not follow from this distinction. The IASB have stated that the Conceptual Framework is the " theoretical foundation of our standards"[7]. It would be strange therefore if the situation for the predecessor Framework were any different. Further that Framework had already downgraded prudence to a mere aspect of neutrality which throws into doubt whether compliance with that Framework would achieve the legally required " prudent basis".

[4] His footnote 5
[5] IAS1 Para 15.
[6] Recital 9 Accounting Directive 9 (2013/34/EU)
[7] Hans Hoogervorst, Chairman IASB in a speech to London School of Economics, Nov 2012

Mr Bompas's conclusions

23 Moore refers in 23(a) to a possible failure "to include the capital maintenance purpose of which reserves are distributable…"which would prevent a true and fair view in the brief to Bompas. It is not clear what this means and it is not quite what was asked.

Moore's conclusions

32 We agree that the Act does not specifically require that the accounts differentiate between distributable and non-distributable profits. We were surprised when Bompas reached this conclusion and it was not a question asked.

Moore states that "The Act [8]uses the more general word " profit" when considering whether a distribution may lawfully made..". The consequence of the use of this word is not clear. S830(2) says that a distribution can only be made out of realised profits. S836 says that the legality of a distribution "is determined by reference to…… profits, losses assets and liabilities" in the relevant accounts. S853(4) defines "realised profits", " for the purposes of this part" and "with respect to the determination for accounting purposes" as those which fall to be treated as such " in accordance with principles generally accepted..".

In view of the definition of realised profits the distinction between the words of s 830- " realised profits"- and of S836 " profits"[used as a reference], is obscure.

Prudence

44 et seq: What we are concerned about is that the concept has been initially devalued and then , in 2010, dropped. FRS18 which replaced SSAP 2, to which Moore refers commented " In conditions of uncertainty, prudence requires more confirmatory evidence about the existence of an asset or gain than about the existence of a liability or loss, and a greater reliability of measurement for assets and gains than for liabilities and losses." [9] Moore also refers to Para 18 of the FRS and Para 37 of the Framework.

All these references deal with " conditions of uncertainty"[10]. It is here, in our view, that the basic error is made. It is assumed that certainty is the norm, whereas the truth is that uncertainty is the norm. The evidence is that we cannot predict the future and thus we cannot and do not know what the future will bring: ergo uncertainty.

This is not to encourage hidden reserves. Prudence is an attitude of mind. A reasonable and cautious judgement has to be made and the use of any e.g. general provisions, additions to such provisions and the balance of such provisions should be disclosed.

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[8] S836(1)(a)
[9] FRS 18 Appendix iv para 14.
[10] Framework para 37.

All company directors are, or should be, optimists. Nobody enters business expecting to make a loss. Thus the restatement in the Conceptual Framework and re-adoption of the concept in underlying IFRS, are both essential and necessary to comply with the law. Auditors need to again have that tool in their armoury of being able to say-"…but that's not prudent".

56 Moore states " "prudence" is an abstract concept and it's …meaning will change and develop over time". This again does not appear to be so. Prudence is an attitude of mind and failure to apply it is a consistent bias to the idea that that we can forecast the future. As we cannot, it is both necessary and right that we err on the side of caution. Conditions of uncertainty always exist. Prudence cannot and does not change.

61 Having argued that there is no problem over prudence Moore then surprisingly advocates the re-adoption of the term " expressly"!

Statutory Accounting principles.

62 et seq ; We agree with Moore that the Accounting Directive allows fair values- whether " mark to market" or " mark to model" to be accounted for. This appears to be an attempt by legislators to go along with IFRS. As a lawyer Moore does not consider whether such permission helps or hinders the attainment of a true and fair view.

True and fair view over-ride

70 et seq: The central question here is whether "Fair presentation" equates to "true and fair". If this is so then it needs stating clearly, presumably in the Conceptual Framework.

As a part of this there needs to be clarity as to whether it is the " Framework" or the " Conceptual Framework" which applies under the law. If it is the former then the latter is irrelevant in assessing the legality of IFRS: if the latter the present absence of prudence becomes even more important.

UKSA Conclusions:

The problems still are

- IFRS have a Framework or Conceptual Framework which does not recognise prudence either partially or at all , but which is the "theoretical basis for our standards"[11]. As we cannot predict the future, failure to be prudent leads to bias towards over optimism. Uncertainty is the norm.

- Does true and fair equate with fair presentation?

[11] Hoogervorst as above; footnote 7

- There is great uncertainty as to the legal position of IFRS as demonstrated by the Bompas-Moore differences. In an area as important as this clarity is required.
- The banks and their auditors got it wrong. Accounting cannot prevent foolishness but it failed to recognise it.
- The EU approval processes have not worked properly.

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