Funding the Future

# Lehman – how it got round the rules by using cons...

Published: January 13, 2026, 12:19 am

---

I’ve been doing a little grubbing around Lehman and its repo accounting.

Report is widespread that the “repo 105” deal that caused the alleged misstatement of Lehman’s balance sheet took place in the UK.

Now it so happens that my information is that Lehman UK reported using UK GAAP i.e. under UK accounting standards.

But, under UK accounting standards a repo is treated as an on balance sheet transaction.After all, it is a sale of an asset matched by an agreement to repurchase it. The transaction has not changed the real structure of the balance sheet as far as UK GAAP is concerned, so the transaction is effectively ignored for reporting purposes. That’s because the risk and reward of ownership of the underlying assets has not changed — they remained with Lehman.

Oddly, as far as I can tell IFRS delivers the same result as far as I can see.

So how come Lehman reported with the benefit of the repos being reflected in the consolidated accounts?

The answer is that US GAAP does not reflect the risk and reward model. It simply asks if there is a sale and then applies a hurdle test. As Prof Mike Page of Portsmouth University wrote on the blog this morning:

*Further research on US blogs seems to suggest that* SFAS 140 was crucial to scheme. I have, as yet, not been able to track down a full text of it but other comment suggests there may be a â€šÃ„Ã²bright line’ that allows a Repo to be treated as a sale if it is for more that 105% of current market value. The exact conditions aren’t set out in online summaries. Given the size of the law suits, what is in the UK (and doubtless some offshore) subsidiaries financial statements may be vital to what US investors might have known about the transactions. I think this is going to be one of the most fascinating accounting cases for a long time. As Richard pointed out, the role of fair-value is likely to be important as the notion of â€šÃ„Ã²market value’ must have been pretty elastic for a lot of the stuff that was apparently put through these Repo transactions.

That’s the hurdle.

And it seems that the Lehman “repo 105” might have been named in honour of that hurdle — over which it jumped.

Some — such as the FT — have suggested that opinions on whether the hurdle had been jumped could be obtained in the UK, but not in the US. Maybe that’s true. But maybe also it was not essential.

The reason is that the resulting misstatement from use of repo 105 will, if I’m right,  not be found in the accounts of  any of the underlying regulated entities within the Lehman group — all of which were stated in accordance with required GAAP. Rather the misstatement was only to be found in those rather vague entries in the books of account of a group of companies called the consolidation journals.

This takes some getting one’s head round for the lay reader. Basically you have to understand that the glossy published accounts of a group of companies — most especially a multinational corporation — are a work of fiction. As my friend Prem Sikka has often said, most should qualify for the Booker Prize.  That’s because of three things:

* There is no entity anywhere that undertakes the transactions recorded in these accounts. The transactions are actually undertaken by a range of other entities — maybe thousands of other entities, which are then added together.

* Except they’re not added together. All the intra-group balances are excluded and all the intra-group trades are excluded. This would not be worrying until you realise that between 60% and 70% of world trade is intra-group — and none of it appears in the consolidated accounts of multinational corporations — which makes clear how misleading they are.

* There is also the possibility that profits and losses can be recorded in the consolidation alone — and balance sheets changed in the process — with the resulting transactions never appearing in the books of any actual company and therefore beyond the reach of taxation and regulation. These are the secretive â€šÃ„Ã²consolidation journals’. In the wrong hands these provide massive opportunity for abuse.

The real question about Lehman then is not just where did the abuse happen that helped bring it down — but did it happen in the ether of the consolidation alone — in the pure make believe world unrelated to reality that is a set of books and records to which no company lays claim in its own books and records?

I think that might be true.

In which case three things follow:

* We need country-by-country reporting which requires the accounts of an multinational corporation to be grounded in a place — not floating in an ether above it;

* We need, as I have suggested, to review the whole nature of limited liability reporting and what it means in groups;

* we need to review accounting even more urgently.

And, finally, someone needs to work out how to prosecute fraud never recorded in the books of a company but nonetheless reported upon in a set of accounts. There's a challenge, if this is true.