Funding the Future

Are International Financial Reporting Standards illegal...

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A new legal opinion, issued to coincide with the report of the Banking Commission, is a damning indictment of International Financial Reporting Standards, and with it the accountants who promoted and endorsed those standards in the Big 4 firms of accountants. The opinion, by George Bompas QC of Lincoln's Inn begins as follows (all footnotes are included for the accounting and legal geeks amongst us):

1 For over half a century it has been established in domestic company law as a fundamental requirement that companies' statutory accounts should give a "true and fair view" of what is being reported on: in the case of a balance sheet, this will be of the company's position at the balance sheet date; in the case of a profit and loss account, this will be of the company's profit or loss in the period covered by the account.

2 However, as discussed below, there is now a tension between this fundamental requirement and requirements of international accounting standards, where those standards have been adopted as a company's applicable accounting framework.[1] "International accounting standards" is a defined expression in the Companies Act 2006 and means "the international accounting standards, within the meaning of the IAS Regulation, adopted from time to time by the European Commission in accordance with that Regulation".[2] The "IAS Regulation" is the amended Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of International accounting standards[3], discussed below.

3 In the Companies Act 2006 the true and fair view requirement is encapsulated in s.393: directors are not to approve their company's annual accounts "unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss". It features also in s.495(3)[4] imposing on auditors a duty to certify whether in their opinion annual accounts among other matters give a true and fair view.

4 Where the applicable accounting framework is the Companies Act one[5], there cannot be any tension between the true and fair requirement and the *requirements resulting from the accounting rules imported by the framework. This is because a statutory requirement forming part of that framework is the true and fair one: see CA06 ss.396(2) & 404(2). The accounts must give a true and fair view. This is paramount within that framework.*

5 On the other hand it is questionable whether statutory accounts prepared in accordance with international accounting standards, where those standards form the applicable framework, will always give a true and fair view; and it is questionable whether international accounting standards admit the possibility of departure from any of their requirements, even where the requirements result in accounts not giving a true and fair view and a departure would be necessary for the accounts to give a true and fair view. The reason for this is that:

5.1 the application of international accounting standards, with additional disclosure where necessary, "is presumed to result in financial statements that achieve a fair presentation" (IAS 1, para 15)[6];

5.2 in consequence international accounting standards do not have any clear subservience to the true and fair concept, there being no articulated, and quite probably no implicit, over-arching requirement that IAS accounts should give a true and fair view (see paragraphs 47 to 59 below); and

5.3 international accounting standards have moved away from the central principle, that of prudence, entailed by the true and fair concept as applied to accounts. [7]

If that is true, and I think it undeniable, then it obviously follows that bank's accounts, at least (because this is what the opinion basically relates to) were illegal in the run up to the 2008 crash and maybe £50 billion of dividends paid by the banks from 2005 onwards were illegal as a consequence. If those dividends had not been paid bail outs may not have been needed: and that is key to this issue.

Now, it is only an opinion - but a powerful one. It also has massive ramifications: if there is no true and fair view in IFRS the whole basis of UK accounting and company law on accounting has been undermined and what other accounts may be illegal?

The time to bring accounting back under proper oversight - and not the oversight of those with vested interest in enduring they give an inappropriate view - has arrived.

Will the government and the EU now step forward and say what they're going to do to address this issue? Given the disaster it gave rise to - which has helped cost hundreds of millions of people in Europe their wellbeing and hope - it's the least they can do.

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[1] *By CA06 ss.395 & 403 individual and group accounts must be prepared either in accordance with specified provisions of the Companies Act or in accordance with international accounting standards. In certain cases there is no choice, and one or other accounting framework is obligatory.*

[2] *CA06 s.474(1).*

[3] *The standards promulgated by the International Accounting Standards Board (previously named the International Accounting Standards Committee) are referred to as International Financial Reporting Standards ("IFRS") rather than International Accounting Standards (a point foreshadowed in recital 7 to the IAS Regulation). It is usual to use the more modern label, IFRS, when referring to the standards which form the applicable accounting framework for accounts prepared in accordance with EU adopted international account standards. In this Opinion, however, for convenience I use the expression which is continued in the Companies Act 2006 when prescribing the alternative accounting framework to UK GAAP. It is also the term used in Article 2 of the IAS Regulation: "For the purposes of this Regulation, 'international accounting standards' shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB)."*

[4] *Set out in paragraph 43 below.*

[5] *That is the one based on GAAP and prescribed by detailed legislation: the "stringent new accounting code" as it was termed by Robert Walker LJ in Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 (see below).

[6] *At the time of when Martin Moore QC gave his Opinion, referred to below, and before later changes to IAS 1 the paragraph was numbered 13. It was set out in full in paragraph 24 of that Opinion, and also in paragraph 49.2 below.*

[7] *This was the position stated by the Chairman of the IASB in a speech on 18 September 2012 at a conference of the Federation of European Accounts. The speech is available on the website of the IFRS Foundation and IASB.*