
As the FT reports this morning:

The UK government ignored advice to put Carillion on its highest risk rating before its collapse in January, following pressure from board members of the now-bankrupt company that was a major supplier of outsourced public services.

If you wish for more information on the story, it's in plenty of newspapers. My belief is that we need to stand back from it and look at precisely what this story means. There are, I suggest, three dimensions to it.

The first is that inappropriate lobbying takes place, and it would appear that the civil service was susceptible to it. That is not my primary concern this morning.

Second, as is now obvious, the risk warnings about Carillion were raised far too late in government circles. It is appropriate to ask why.

Third, although not apparent from the above quotation, what the Public Accounts Committee report that underpins it makes clear is that there were just four potential ratings for a supplier of outsourced services to the government. These were green, amber, red and black: the last being the clearest indication that there was a previous three-tier system to which somebody thought a higher risk rating needed to be added.

Let me offer some thoughts on this, starting with the third issue first. What the simple indicator used demonstrates is that even supposedly sophisticated users of financial information are not able to analyse them in any complex fashion. I stress before the inevitable naysayers get in that the civil service will not be alone in this: we humans are simply not very good at handling complex data and resort to heuristics as a result.

What I also stress is that there is nothing wrong with this: better a heuristic than no indicator at all. The four-level risk indicator used might well have been appropriate if suitable data to make sure that the appropriate risk warnings were given had been available.

This then brings me back to the second point, that risk warnings were given too late. Part of this may, very clearly, have been the result of lobbying: indeed, I strongly suspect that is the case. But there is another dimension to this, and that is that the accounting data put out by Carillion was simply not fit for the purpose for which it was used.

In fairness to Carillion, this was not their fault. The information they produced was deemed appropriate by International Financial Reporting Standard and their auditors, whose sole real task is, these days, to ensure that they comply with those standards. But the reality is that the company, its internal accountants, the International Accounting Standards Board who produce International Financial Reporting Standard and the auditors all knew that the data that they produced was not intended to, and probably could not, meet the needs of the government in appraising the risk that it faced in contracting with Carillion. This is because IFRS accounts are quite specifically not designed to fulfil this task. I know this because the conceptual framework for IFRS says (in summary):

The primary users of general purpose financial reporting are present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments, providing or settling loans or other forms of credit, or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

The paradox will be apparent: what the IFRS call ' general-purpose financial reports' are in fact decidedly specific information designed to suit the needs of a tiny proportion of the users of financial statements.

The IFRS conceptual framework then keeps digging holes for itself, saying:

The IFRS Framework notes that general purpose financial reports cannot provide all the information that users may need to make economic decisions. They will need to consider pertinent information from other sources as well.

This, of course, is a statement of pure contempt. The IASB knows that the company only publishes one set of accounts and that there will, therefore, be no alternative source of information on the financial affairs of the company for most users, but it does nonetheless tell them that they are on their own when finding it, knowing full well it will never be available.

Now, of course, it is true that a government who is a major contractor to a company could ask for additional financial information to support the contracts given. I do not dispute that. I rather hope it happened. But the fact is that the government was seeking to test the solvency of the company when moving Carillion to a high-risk status and the only useful information available for that purpose is the overall financial statements, which in this situation were not designed to fulfil that goal.

The International Accounting Standards Board claims that its International Financial

Reporting Standard will result in general-purpose financial statements of use to the public. Rarely has a more misleading claim been made. IFRS accounts are not general-purpose financial statements; there are tools designed to assist high-frequency stock market speculation. And since most of the public does not participate in that activity for the vast majority of users of financial statements the information provided by IFRS accounts is knowingly not fit for purpose.

As a result nor is the International Accounting Standards Board.

And nor should accounts based on International Financial Reporting Standards be deemed acceptable in UK company law.

As long as they are we will get more Carillions.