

Independent Review of the Financial Reporting Council [1]

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The Kingman Review has been tasked with looking at the future of the Financial Reporting Council. This is the supine body that until threats to its own existence forced it into a little action was hopelessly ineffective in supervising U.K. auditors. I am well aware that submissions on these failings are being made to the Review, so I chose a different tack when submitting evidence this week, which was as follows, barring the deletion of some biographical detail:

Independent Review of the Financial Reporting Council — Call for Evidence

This submission is made in response to the above call **[1]**. **It addresses some of the issues raised in your call. It is being made by Richard Murphy, who is Professor of Practice in International Political Economy, City, University of London [2] and Director of Tax Research UK [3]. He is a Fellow of, and holds a practising certificate from, the Institute of Chartered Accountants in England and Wales and is an Honorary Fellow of the Association of International Accountants (AIA).**

The questions to be addressed

This submission primarily concerns itself with questions eighteen to twenty-one in the call for evidence. These are as follows:

Q18: Has the FRC been effective in influencing the development of accounting standards internationally as well as accountable and effective in setting UK GAAP?
Q19: How else could the FRC improve the quality of financial reporting with a view to ensuring investor confidence?
Q20: Are there wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders?
Q21: Is the current combination of statutory and voluntary methods of oversight for professional bodies effective, and do they remain fit for the future?

Discussion of the issues

Much of the criticism of the Financial Reporting Council ('FRC') has focused on its

failings with the regard to audit and the regulation of the largest firms of auditors, including the Big 4 firms. Others will submit evidence on those issues, but if the FRC is to really fulfill its objectives then reform in the areas addressed by the above noted questions is also essential. That is why this submission chooses to focus on them.

The FRC says that its objective is to 'promote transparency and integrity in business'[\[61\]](#). ***I doubt that this is true. If it was then the change in direction in UK generally accepted accounting principles ('GAAP'), and in International Financial Reporting Standards ('IFRS') in recent years would not have happened.***

The purpose of accounting standards is to assist the production of general-purpose financial statements[\[71\]](#). ***In other words, the aim is to produce a statement that reports the income, financial position and cash flow of the reporting entity in a way that the general user of that statement might find useful. This is an object promoted in the public interest. What is more, it is one intended for public consumption: a significant number of the entities that will be required to report using these standards in the UK are also required to file some or all of the resulting report on public record.***

This general requirement to produce a general report for general use creates a standard in itself by which the work of the FRC can be assessed. Against that standard the FRC is failing.

In 1975 the then UK Accounting Standards Steering Committee published a report entitled 'The Corporate Report'[\[81\]](#). ***In that seminal document it was said that there were seven stakeholder groups whose needs had to be met by what are now known as general-purpose financial statements. They were***[\[91\]](#):

- * ***Suppliers of share capital to the company;***
- * ***Suppliers of loan capital to the company;***
- * ***Advisers to suppliers of capital;***
- * ***Those trading with an entity;***
- * ***Employees of the entity;***
- * ***Civil society more generally, including (they specifically noted) taxpayers, ratepayers, consumers and other community and special interest groups including political parties, environmental protection societies and regional pressure groups;***
- * ***Regulators, including but not limited to tax authorities.***

The list did of course presume that the obligation might extend to those not

just in a category, but who might join it. That categorisation of potential users of general-purpose financial statements still seems appropriate. It is impossible to argue that any of those identified as users in 1975 have ceased to be so since then. It is possible that in each category the range of users, and the range of interests that they might have has expanded but it is important to note just how broad-minded the Accounting Standards Steering Committee was in 1975.

Against this benchmark for expectation it is, then, quite extraordinary that two developments have become widespread in the intervening years. The first of these has been the restriction in the scope on those who it is assumed that general purpose financial statements now serve. It is now assumed both for the purposes of UK GAAP and IFRS that general purpose financial statements are produced solely for the benefit of the suppliers of capital to an entity[10] and that other users must make use of the data produced to meet that group's needs or have their needs go unmet[11]. By simple and obvious deduction it is apparent as a consequence that general purpose financial statements are no longer any such thing. As a result the accounts that should be produced in the public interest are no longer being produced for that purpose. They are instead being produced in the interests of a particular private purpose. That the FRC has failed to notice this, or remedy the defect, is the clearest possible evidence of its failure to undertake its duties in the public interest.

A simple example of this failure to serve the public interest can be found in the case of public country-by-country reporting. I will presume the Review is familiar with this proposal, which I first suggested in 2003[12]. As a result of enormous civil society pressure this accounting standard (for that is exactly what it is, and has always been, as my first iteration makes clear) is now being used for tax reporting to tax authorities by multinational corporations as a result of Organisation for Economic Cooperation and Development requirements introduced as part of the Base Erosion and Profits Shifting process[13]. However, despite the parallel demand that the same data be made available on public record to meet the needs of the user of the general purpose financial statements of multinational corporations in all those places in which it might operate the International Accounting Standards Board, on behalf of the IFRS Foundation, and the FRC as the UK accounting standards setter, have steadfastly refused to engage with this issue. They have no excuse for not knowing of the proposals[14].

When I asked for a meeting with the FRC to discuss this issue in 2016 I was told that country-by-country reporting fell outside the scope of the annual report, and so the FRC's concern, despite country-by-country reporting being the single most pressing issue in civil society debate on accounting in the last

decade and despite the fact that the EU Parliament has been passing resolutions in favour of public country-by-country reporting for much of that period. In conversation with the FRC I was told that this was 'simply a tax issue' and therefore of no concern to it.

There are two obvious reasons why these suggestions from the FRC are untrue. One is that even if this was 'just a tax matter' the FRC should, if it were to actually promote the production of general-purpose financial statements, be requiring the publication of data that is of use to tax authorities and not declare that this is a matter beyond the remit of accounting standards setters. Second, the most cursory review of literature on this issue would show any open-minded reader that this is not an issue that solely relates to tax. It is instead an accounting disclosure issue since the information required is derived from the general ledger of reporting entities and has no direct role in tax assessment, at all. Country-by-country data is then, and only ever can be, accounting data. The FRC's refusal to engage with this issue despite this fact is, then, clear indication that it does not think it has a public interest mandate, or a duty to produce general-purpose financial statements, and that it does not actually support their production. As a result it very clearly is not fulfilling its public mandate. The result is that the FRC has not fulfilled its public duty remit. It has, then, to be replaced by a body or bodies that will do so.

Specific responses to questions raised

I provide the following specific response to the noted questions raised:

Question 18

The FRC has been ineffective in influencing the development of accounting standards internationally as well as in being ineffective and unaccountable in setting UK GAAP. It has, in fact, deliberately hindered this process by seeking to reduce the scope of those standards so that they do not meet the public interest by ensuring that they do not result in the production of general-purpose financial statements.

Question 19

The FRC can no longer improve the quality of financial reporting with a view to ensuring investor confidence. That is because if it was to have done so the chance has gone. It has failed to influence IFRS to achieve this goal. It has introduced a version of UK GAAP that may well be incomprehensible to the majority of directors who will be expected to comply with its requirements. And it has taken no steps to ensure that, in cooperation with other agencies such as Companies House, its standards are adhered to by the vast majority of companies that do not require an audit.

Question 20

There are wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders. In particular it is suggested that a replacement organisation for the FRC will need to ensure that:

- * The full financial statements of all UK limited liability entities should be filed on public record to ensure that UK GAAP is complied with in all cases. This is not the case at present, both because of failure in legal requirement and as a result of failure to enforce the law that does exist, meaning that general purpose financial statements are not available to all who need them and have a right to expect that they should be available for their use;
- * Effective enforcement regimes are available to ensure that all entities, of whatever size, comply with accounting standards. This will always involve personal fines to be paid without the protection of limited liability or insurance by the individuals responsible for the breach;
- * General-purpose financial statements must be capable of being understood by any person who, within reason, might be appointed to accept responsibility to prepare those statements. This does mean obligations may vary by size of entity but must never require comprehension of concepts beyond those required, for example, for basic level admission to a UK university course;
- * A statutory definition of general-purpose financial statements and their contents is in UK statute;
- * UK accounting standards, and their IFRS equivalent, must have parliamentary approval;
- * A statutory definition of what is considered to be true and fair is provided;
- * A public interest duty is imposed on all companies requiring that at all times:
 - * The company will be run with the interests of its creditors (including its employees) and the obligation to make timely settlement to them on a timely basis be considered the primary duty of the company;
 - * The obligations to stakeholders will always be considered as ranking equal with those of the suppliers of capital to the company and when the two are in conflict the interests of the owners of capital will always come second;
 - * Any company that cannot demonstrate adherence to these standards will be treated as trading with unlimited liability on the part of the directors and those from whom they take instruction unless they can prove to the contrary;
- * The interests of stakeholders are ranked equally with those of the suppliers of capital

in the accounting standards setting process.

Question 21 The current combination of statutory and voluntary methods of oversight for professional bodies is ineffective, and is not fit for the future. Professional bodies are no more than trade organisations that have always acted to create ring-fences that reinforce the ability of their members to make profit at cost to the public at large. They are inherently conflicted and unable to act as regulators as a consequence. The only available option for oversight of the accounting profession is that it be undertaken by a statutory body that is itself independent of the statutory body that is responsible for establishing accountancy, auditing and corporate governance standards.

I shall be pleased to discuss this submission with you.

[1]

<https://www.gov.uk/government/consultations/financial-reporting-council-independent-review-call-for-evidence>

[2] <https://www.city.ac.uk/people/academics/richard-murphy>

[3] <http://www.taxresearch.org.uk/Blog/>

[5]

<http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm>

[6]

<https://www.gov.uk/government/consultations/financial-reporting-council-independent-review-call-for-evidence> page 4

[7] <https://www.iasplus.com/en-gb/standards/other/framework>

[8]

<https://www.icaew.com/library/subject-gateways/corporate-reporting/the-corporate-report>

[9]

<https://www.icaew.com/-/media/corporate/files/library/subjects/corporate-governance/corporate-report.ashx?la=en> page 17

[10] IFRS Conceptual framework para 1.2

[11] IFRS Conceptual framework paras 1.6 and 1.10

[12] <http://visar.csustan.edu/aaba/ProposedAccstd.pdf>

[13]

<http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm>

[14] See, for example, this overview from KPMG published in 2016
<https://home.kpmg.com/content/dam/kpmg/pdf/2016/07/cbcr-kpmg-cbcr-overview-and-comparison-of-initiatives-15042016.pdf>