The Local Authority Pension Fund Forum (LAPFF) was set up in 1991 and is a voluntary association of 72 public sector pension funds based in the UK with combined assets of approximately £200 billion. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest.

SUMMARY OF POSITION

LAPFF welcomes the opportunity to respond to the Consultation. As an investor forum, LAPFF believes that robust rules, application and practice on accounting and financial reporting are essential to safeguard the interests of pension fund beneficiaries.

LAPFF has been concerned about the FRC’s approach to director duties and the strategic report. These concerns emerged also from discussions that LAPFF had, together with some NGO’s, on the subject of climate change with FRC executives. Similar concerns were raised by others in the wake of issues with BHS and Sports Direct¹.

LAPFF believed that the problem was not the requirements of the legislation for director duties (s172) or for the strategic report (s414C), but the way in which the FRC guidance on the legislation had left out parts of the text of s172 by choosing to cite the short-title of the section rather than the content of that section of the statute itself. It was quite clear there was an error by reading the government’s correct description of the legislation in its Corporate Governance Green Paper of November 2016.

LAPFF does not find the explanation that an EU Directive has altered things as compelling, as that Directive does not touch on the parts of s172 for which the FRC has now correctly transposed the existing 2006 Act text.

That said, it is positive that the wording is now correct in this revised guidance.

However, the FRC has some way to go in updating other publications and guidance for transcription errors. The problem of the FRC using the short title, rather than the text, repeats itself regarding s393 Companies Act 2006 (True and Fair view). That error can be seen in the FRC’s 2011 and 2014 papers on ‘True and Fair View’. The correct wording of the statute ‘true and fair view of the assets, liabilities,

¹ e.g. by the BEIS Select Committee. House of Commons
financial position and profit or loss' doesn’t actually appear anywhere in those papers. Those papers contain shortened and inaccurate text instead.

There are other problems with the transcription of other parts of legislation, including FRC guidance on qualified audit reports, section 837(4). The FRC guidance on the legislation states that an auditor statement in lieu of an unqualified audit opinion targets the dividend cover of a proposed distribution\(^2\).

That is incorrect, and s874(5) could not be clearer that the statutory requirement relates to the distribution capacity that the accounts show, and not dividend cover of any proposed dividend/distribution\(^3\). That is a very material defect.

Also, the same guidance is defective by omission. The guidance states, correctly, that the test of lawfulness is set out in Part 23 Companies Act. It then cites the profits test (s830 CA 2006), however, it misses (s831 CA2006), the net assets test altogether. That is also a very material defect.

The impact of the FRC’s erroneous guidance is that it fails to highlight that net assets as well as profits are relevant to distributions for a public company, and hence relevant to whether an auditor report is qualified or not. Given the gearing of banks, and the sensitivity of banks’ net assets to inadequate bad debt provisioning, the FRC’s problems in this area are clearly relevant to the audits of banks which failed within months of receiving clean audit opinions: HBOS, Co-op Bank, RBS and others are examples of this in practice.

Rather surprisingly, the FRC does refer correctly to s831 in its application of that test in its guidance on s92, which is included in the same document.

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\(^2\) Miscellaneous Reports by Auditors Required by the United Kingdom Companies Act 2006, para 11 and 12 and the model report contain the error.

\(^3\) The FRC guidance correctly cites the text in footnote,