INTERNATIONAL FINANCIAL REPORTING STANDARDS

(Issues arising in relation to the Companies Act 2006)

OPINION

Introduction

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.

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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)."*

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 <u>must</u> 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

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[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.

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]

6 In April 2008 Martin Moore QC gave an Opinion for the Financial Reporting Council in which he concluded that the international accounting standards accounting framework recognised that a departure from an accounting standard might be necessary where compliance with the standard "*would produce a result so misleading that it would conflict with the objective of financial statements*"[8]. However, this conclusion he rested on IAS 1 (discussed later in this Opinion at paras 47ff), saying that "*IAS 1 permits a departure from IFRS if a particular IFRS would be so misleading that it would conflict with the objective of the financial statements set out in the Framework*"[9]; and he extracted from the Framework an objective of presenting information fairly, or achieving a fair presentation, this in his view meaning the same as giving a true and fair view.[10]

7 A difficulty with Mr Moore's Opinion is that since 2008 "the Framework" referred to in IAS 1 (that is, the Framework for the Preparation of Financial Statements adopted by the International Accounting Standards Board in 2001) has been replaced with a new "Conceptual Framework for Financial Reporting" ("the Conceptual Framework"). A passage in the Framework referred to and relied upon by Mr Moore in his Opinion, namely paragraph 46 quoted in paragraph 28 of the Opinion, is not to be found set out in the Conceptual Framework.[11] Further, while IAS 1 does

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[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.

[8] Paragraph 38 of the Opinion.

[9] Paragraph 37 of the Opinion.

[10] Paragraphs 28 and 29 of the Opinion.

[11] Not only this, but in addition the reference made by the Framework to "prudence" as an element in the production of reliable accounts (paragraph 37 of the Framework) finds no equivalent in the Conceptual Framework.

permit a degree of departure, as mentioned in the passage from the Opinion quoted at the end of paragraph 6 above, where it does so (notably paras 15, 19, 23 and 24 of IAS 1) it is by reference to matters in the Framework which are not stated, or stated in the same way, in the Conceptual Framework. In this respect the landscape appears to have changed since the Opinion was given.

8 If then, in a case where international accounting standards provide the applicable accounting framework for statutory accounts, their application will not result in the accounts giving a true and fair view, the company's directors will be in a difficult position.

8.1 By CA06 s.393 the directors are not to approve the accounts (see CA06 s.393). Quite what they are to do with the accounts, and how they are to comply with their obligation to cause accounts to be laid before the general meeting and delivered to the Registrar of Companies, is not explained by the Companies Act, if they find that the application of the rules of the appropriate accounting framework result in accounts which do not give a true and fair view.[12]

8.2 The auditors' report on the accounts will, in response to the requirement in CA06 s.495(3)(b), no doubt be able to confirm the preparation of the accounts in accordance with the relevant accounting framework, while at the same time confirming in response to the requirement in CA06 s.495(3)(a) that the auditors are unable to say that that the accounts give a true and fair view.

9 I have been asked to give consideration to the way in which the tension referred to above might be resolved.

10 In particular I have been asked the following two questions:

10.1 Can EU adopted international accounting standards, as required under Article 4 of the IAS Regulation and permitted under Article 5 of the IAS Regulation, satisfy the true and fair view principle of CA06 s.393, Article 2(3)

[12] The assumption underpinning CA06 s.393 is that it is always open to directors to ensure that their company's accounts give a true and fair view, whatever accounting framework is the applicable one.

of the Fourth Directive[13] and Article 16(3) of the Seventh Directive[14], and hence satisfy the requirement of Article 3 of the IAS Regulation, by virtue of:

10.1.1 The **failure of IFRS to include the capital maintenance purpose of accounts** and in particular the creditor and shareholder protection requirement to account for *inter alia* distributable profits and distributable reserves required by Part 23 Companies Act 2006 and the Second Directive[15], for which giving a true and fair view is the required standard.

10.1.2 The **failure of IFRS to require prudence as a fundamental accounting principle**, as required for the preparation of accounts for a true and fair view under Article 31(1)(c) of the Fourth Directive, and the equivalent requirement of the Seventh Directive and confirmed as necessary by the European Court of Justice (notably ECJ C-275/97: *Bauunternehmung*, ECJ C234/94 *Tomberger*).

10.1.3 The **failure of individual IFRS to follow statutory accounting principles**, including in particular:

i. IAS 39 allowing unrealised mark to market "profits" and mark to model "profits" in valuations, contrary to the requirement of prudence to include only realised profits required under Article 31(1)(c)(aa) of the Fourth Directive, and the equivalent requirement of the Seventh Directive, and

ii. IAS 39, but not only IAS 39, not accounting for all foreseeable liabilities and likely losses irrespective of the time in which they arise, contrary to the requirement of prudence under Article 31(1)(c)(bb) of the Fourth Directive, and the equivalent requirement of the Seventh Directive.

10.2 Does the true and fair view requirement of CA06 s.393 and the Fourth and Seventh Directives take precedence over any international accounting

[13] Fourth Council Directive of 25 July 1978 (78/660/EEC).

[14] Seventh Council Directive of 13 June 1983 (83/349/EEC).

[15] Second Council Directive of 13 December 1976 (77/91/EEC).

standards adopted for use under Articles 4 and 5 of the IAS Regulation while being contrary to the true and fair view requirements of Article 3 of the IAS Regulation?

11 In summary my answers to the questions are:

11.1 No, if as a matter of accounting an apparently adopted international accounting standard has the results specified in paras 10.1.1 to 10.1.3, and if international accounting standards do not allow for any overriding true and fair requirement.

11.2 Yes.

Discussion

[The true and fair requirement]

12 Following recommendations made in the 1945 Cohen Report to Parliament[16], the Companies Act 1947 introduced the statutory requirement that companies' accounts should give a true and fair view[17], this being a paramount requirement (see CA47 s.13(1)-(3) and s.16(1)&(3)). This requirement was, of course, repeated in the Companies Act 1948 (CA48 s.149(1)-(3) and s.152(1)&(3)); and it has been carried through the succeeding major amendments to the statutory accounting requirements down to 2004 (that is, the Companies Act 1967, the Companies Act 1980, the Companies Act 1981, the Companies Act 1985, and the Companies Act 1989).

13 In the Companies Act 1948 the material provision for individual company accounts, CA48 s.149, was as follow:

> *"(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.*

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[16] Report of the Committee on Company Law Amendment, paras 96 to 105 and Recommendation I.

[17] The Companies Act 1929 had, by s.134(1), contained a requirement for auditors' reports on any balance sheet laid before the company in general meeting to state *"whether, in their opinion, the balance sheet ... is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs ..."* (emphasis added).

(2) A company's balance sheet and profit and loss account shall comply with the requirements of the Eighth Schedule to this Act, so far as applicable thereto.
(3) Save as expressly provided in the following provisions of this section or in Part III[18] *of the Eighth Schedule the requirements of the last foregoing subsection and the said Eighth Schedule shall be without prejudice either to the general requirements of subsection (1) of this section or to any other requirements of this Act."*

14 In the 1985 Companies Act the equivalent requirement was set out in CA85 s.226(1)-(5) (for individual accounts) and 227(3)-(6) (for consolidated accounts), sections which had evolved from the corresponding ones in the 1947 and 1948 Companies Acts but, with amendments introduced by the Companies Act 1981, now gave effect to the Fourth and Seventh Directives and reflected the language of the Article quoted below.

15 The paramount true and fair requirement was supplemented by further requirements as to the form and content of accounts. In the Companies Acts 1947 and 1948 the supplemental accounting requirements (requirements that is as to form and content of accounts), were introduced by sections already referred to above (CA47 s.13(3) and 16(3); CA48 s.149(2) and 152(3)) and were set out in a schedule (Schedule 8 in the case of CA48). With succeeding Companies Acts the supplemental requirements were elaborated on, most importantly in the Companies Act 1981 (see below).

16 The impetus for the changes made by the Companies Act 1981 was the Fourth Directive. Article 2, the only Article in Section 1 of the Directive (the Section headed "General provisions"), provides for an overriding requirement that accounts should give a true and fair view. It does so in the following terms:

"1. The annual accounts shall comprise the balance sheet, the profit and loss account and the notes to the accounts. These documents shall constitute a composite whole.
2. They shall be drawn up clearly and in accordance with the provisions of this Directive.
3. The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit and loss.

[18] Part III provided exceptions for special classes of company.

4. Where the application of the provisions of this Directive would not be sufficient to give a true and fair view within the meaning of paragraph 3, additional information must be given.
5. Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3. Any such departure must be disclosed in the notes on the accounts together with an explanation of the reasons for it and a statement of its effect on the assets, liabilities, financial position and profit or loss. The Member States may define the exceptional cases in question and lay down the relevant special rules ..."

17 The following parts of the Fourth Directive contain general and detailed provisions as to the balance sheets and profits and loss accounts, dealing with in particular layout and content. For the purposes of this Opinion Article 31, in Section 7 headed "Valuation rules", is material. This provides as follows (emphasis added):

"1. The Member States shall ensure that the items shown in the annual accounts are valued in accordance with the following general principles:
- *(a) the company must be presumed to be carrying on business as a going concern;*
- *(b) the methods of valuation must be applied consistently from one financial year to another;*
- *(c) valuation must be made on a prudent basis, and in particular:*
  - *(aa) only profits made at the balance sheet date may be included,*
  - *(bb) account must be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or of a previous one, even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up,*
  - *(cc) account must be taken of all depreciation, whether the result of the financial year is a loss or a profit;*
- *(d) account must be taken of income and charges relating to the financial year, irrespective of the date of receipt or payment of such income or charges*

....

2. Departures from these general principles shall be permitted in exceptional cases. Any such departures must be disclosed in the notes on the accounts and the reasons for them given together with an assessment of their effect on the assets, liabilities, financial position and profit or loss."

18 Thus, by Article 2 the Fourth Directive provides for there to be a paramount requirement that accounts should give a true and fair view. Where providing supplemental information could meet the requirement, that information was to be provided. Where, however, providing supplemental information would not be sufficient, the requirement to give true and fair would displace other specific

requirements of the directive. Not only is this obvious from the clear language used, but it is established by three judgments of the European Court (Case C-234/94 *Tomberger* [1996] ECR I-3133; Case C-275/97 *DE+ES Bauunternehmung* [1999] I-5331; Case C-306/99 *Banque Internationale pour l'Afrique Occidentale* [2003] ECR I-1). At paragraphs 72-3 in the judgment in the last of these three cases the point was made that:

> *"Finally, with regard to the content of the Fourth Directive, both the fourth recital in its preamble and Article 2(3) state as a fundamental principle that annual accounts must give a true and fair view of the company's assets and liabilities, financial position and profit or loss... However, in accordance with Article 2(5) of the Fourth Directive, where the application of a provision of the directive is incompatible with the 'true and fair' principle, that provision must be departed from in order to give a true and fair view ..."*

However, nothing in this judgment (or in the two other cases mentioned above) supported the proposition that a departure from the provisions of the Directive would be permissible otherwise than where permitted by Article 2(5), that is where the application of the provision would be incompatible with the "true and fair" provision.

19 The Seventh Directive carried the principles of the Fourth Directive through into the requirements for consolidated accounts. The pattern was the same, Article 16 of the Seventh Directive mirroring Article 2 of the Fourth Directive, and Article 29 of the Seventh Directive importing Article 31 of the Fourth Directive.

20 The fundamental requirement that statutory accounts should give a true and fair view was reinforced by the provisions of the Companies Acts concerning auditors' duties and their audit reports. In the 1947 Act the requirement was developed from that in the Companies Act 1929 referred to in footnote 17, and now was that the audit opinion should include an opinion as to the giving by the accounts of a true and fair view (CA47 s.22 & Sch 2 paras 3 & 4; cf CA48 s.162 & Sch 9 paras 3(2) & (3)). In the Companies Act 1985 the requirement for the auditors' report was not only to state whether the relevant accounts had been properly prepared in accordance with the Companies Act but also without prejudice to that whether they gave a true and fair view of the state of affairs of the company, of profit and loss (where the accounts were individual company accounts), and of the state of affairs and profit

and loss of the company and subsidiaries (where the accounts were group accounts): see CA85 s.236(2).[19]

21 The short of this discussion was that until 2004 the requirement that statutory accounts should give a true and fair view was solidly embedded into domestic law.

[The concept of a "true and fair view"]

22 The concept of what is a true and fair view for the purpose of the statutory true and fair view requirement has been discussed in several Opinions given by distinguished Counsel: Leonard Hoffmann QC and Mary Arden in 1983 and 1984, Mary Arden QC in 1993 and Martin Moore QC in 2008. It is unnecessary to rehearse all the detailed discussion of those Opinions as to what is meant by the expression "a true and fair view"[20] or as to the chain of reasoning likely to be applied by a court in deciding whether in any case the requirement for giving a true and fair view has been met. For present purposes it is sufficient to note the following:

22.1 The concept has been described as "dynamic".[21] This does not mean that the concept changes: words by which the concept is defined are ordinary words of the English language and easily understood. What it means is that content of the concept can change in that what at one period might be regarded as falling within the definition may at another period not be so regarded.[22]

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[19] This provision derived from CA67 s.14, which had replaced CA48 s.162. The Companies Act 1989 changed this provision slightly, simplifying the position so that it was clear that a particular feature of statutory accounts prepared in accordance with the Companies Act was that the accounts gave a true and fair view (CA85 s.235(2) as amended by CA89).

[20] Except for the time when the amendments to the Companies Act 1985 effected by the Companies Act 1985 (Accounting etc) Regulations 2004 (SI 2004/2947) remained in force, there has been no statutory definition of what is meant by the expression "give a true and fair view" used in the Companies Acts. This definition while in force was only relevant in the case of IAS accounts: in the case of Companies Acts accounts the definition was circular, so that in effect it defined giving a true and fair view as giving a true and fair view.

[21] See paragraph 16 of the Opinion of 13 September 1983 given by Leonard Hoffmann QC and Mary Arden.

[22] See, as to this, the illustration of the area, changing with the passage of time and the refinement of sensibilities, of what is embraced by the expression "cruel and unusual punishment". This illustration was given in paragraph 12 of the Opinion referred to in the previous footnote.

22.2 The content of the concept is, from time to time, informed by statutory requirements, accounting principles, and the expectations and understandings of users of accounts (directors, shareholders and investors, creditors and lenders, regulators and so on). Naturally as these evolve so too may the content of the true and fair view concept.

22.3 However, it does not follow that simply because an accounting rule is changed, accounts produced in accordance with the changed rule would necessarily be taken to give a true and fair view where the same presentation of information before the change would not have been taken to give a true and fair view. This is the obverse of the point made in paragraph 16 of the Opinion of Leonard Hoffmann QC and Mary Arden of 13 September 1983: there the point was that accounts prepared on the basis of valuation rules set out as available in the Companies Act may be found to fail to give a true and fair view because by the time of the accounts accounting practice had developed.

[Prudence]

23 I have set out above the terms of the material parts of Articles 2 and 31 of the Fourth Directive. The Companies Act 1981 made amendments to CA48 Sch 8 so that now the form and content of company accounts was to follow the pattern prescribed by the Fourth Directive. Most significantly Part II of the Schedule set out various accounting principles including the principle of prudence:[23]

> "12. *The amount of any item shall be determined on a prudent basis, and in particular–*
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> *(a) only profits realised at the balance sheet date shall be included in the profit and loss account; and*
>
> *(b) all liabilities and losses which have arisen or are likely to arise in respect of the financial year to which the accounts relate or a previous financial year shall be taken into account, including those which only become apparent between the balance sheet date and the date on which it is signed ...*"

24 My understanding is that with this statutory recognition of prudence as a principle informing the determination of amounts of items in statutory accounts, the principle

[23] The principle, in other words, in Article 31(1)(c) of the Fourth Directive.

became a statutory ingredient of the true and fair view concept: it would not be readily understood, whether by the courts or by users of accounts, how accounts which had been prepared without prudence being applied in the determination of amounts of items could nevertheless give a true and fair view. Featuring as it has in statutory provision, in the Fourth Directive (and by reference in the Seventh Directive), and in accounting practice as described below, the principle of prudence is deeply engrained as a necessary element of accounts giving a true and fair view.

25 Not only was prudence embedded by statute, but it had long been as a fundamental accounting concept; that is to say, in preparing accounts giving a true and fair view. SSAP 2 issued as long ago as November 1971, in setting out what are *"fundamental accounting concepts"*, had included the concept of *"prudence"*. The SSAP explained this concept as being that *"revenue and profits are not anticipated, but are recognised by inclusion in the profit and loss account only when realised in the form either of cash or of other assets the ultimate cash realisation of which can be assessed with reasonable certainty; provision is made for all known liabilities (expenses and losses) whether the amount of these is known with certainty or is a best estimate in the light of the information available"* (para 14 of the SSAP). The preamble to the SSAP had explained among other things that the SSAP sought to achieve improvement in the quality of information disclosed by *"establishing as standard accounting practice the disclosure in financial accounts of clear explanations of the accounting policies followed in so far as these are significant for the purposes of giving a true and fair view."* The SSAP also explained, in relation to prudence among other concepts, that *"they have such general acceptance that they call for no explanation in published accounts and their observance is presumed unless stated otherwise. They are practical rules rather than theoretical ideals and are capable of variation and evolution as accounting thought and practice develop but their present generally accepted meanings are restated in paragraph 14 below"* (para 2 of the SSAP, captioned *"Fundamental accounting concepts"*).

26 For Companies Act accounts the principle of prudence is expressed, and has been since 1981, in much the same language as set out above: now it is to be found in schedules to the Large and Medium Sized Companies and Groups (Accounts & Reports) 2008 (SI 2008/410) dealing with different types of company (see, eg, Sch 1

para 13, applicable to companies which are not banking and insurance companies).[24] A change to the language, introduced by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004, SI 2004/2947, has been the deletion from paragraph (b) of both the reference to *"losses"* and the reference to matters *"likely to arise"*. However, this change does not detract from the point that the prudence principle is required to be applied in the determination of amounts, paragraph (b) containing only a particular example of the application of the principle.

27 A point of debate among accounting professionals and professional users of accounts is the extent to which the prudence principle is retained in international accounting standards. I discuss later the importance of the Framework for the Preparation of Financial Statements ("the Framework") adopted by the International Accounting Standards Board in April 2001. At this stage it is sufficient to note that while paragraph 36 of the Framework pointed out under the heading *"Neutrality"* that information in financial statements should be neutral to be reliable[25], paragraph 37 under the heading *"Prudence"* explained that in dealing with uncertainties, *"prudence is the inclusion of a degree of caution in the exercise of judgments needed in making the estimates required under conditions of uncertainty such that assets or income are not overstated and liabilities or expenses are not understated."* In other words, the principle of prudence certainly did have a place, even if not stated in the clear language used in the Companies Act 1981 and subsequent legislation dealing with statutory accounts.

28 Since September 2010 the Framework has been superseded and replaced by the Conceptual Framework for Financial Reporting. While the Conceptual Framework continues to contain reference to neutrality as an aspect of the qualitative characteristics of the information required for financial statements, the reference to

[24] For Small companies the same requirement is in Sch 1 para 13 of the applicable regulations (SI 2008/409).

[25] *"To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgment in order to achieve a predetermined result or outcome"*. This description of neutrality seems directed at the ruling out of biased selection or presentation of information, rather than at the general approach (for example one of caution) to be taken when forming judgments.

prudence finds no expression. The removal of any reference to prudence has been no accident, as is clear from the speech of the Chairman of the IASB given on 18 September 2012 and at a conference of the Federation of European Accountants. He referred to the 2010 change as having involved the replacement of the concept of prudence by neutrality.[26]

[Showing realised profits and distributable reserves]

29 The Cohen Committee noted at paragraph 98 of their Report, referred to above, that *"As stated in the evidence of the Institute of Chartered Accountants, 'the function of a balance sheet may be stated briefly to be an endeavour to show the share capital, reserves (distinguishing those which are available for distribution as dividends at the date as at which it is prepared), and the manner in which the total moneys representing them are distributed over the several types of assets...'"*.

30 In 1980 legislation was introduced codifying what was and was not to be distributable by a company to its members, superseding the elaborate and confusing common law rules concerning the determination of amounts which were and were not distributable.[27] The Second Council Directive of 13 December 1976 (77/91/EEC) required express provision to be made for maintenance of capital, restricting distributions to profits and available reserves. The 1980 Companies Act gave effect to this, by Part III, introducing a statutory code for determining what could be distributed and, in particular in the case of public companies, what was required for maintaining capital (CA80 s.40; the equivalent provision is now CA06 s.831). In summary only "realised profits" net of realised losses and distributions could be distributed (CA80 s.39; now CA06 ss.829 & 830), and the determination of amounts available for distribution was to be by reference to a company's "relevant accounts"

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[26] Curiously, in paragraph 13 of a submission of January 2013 from the IASB to the Parliamentary Commission on Banking Standards' Panel on tax, audit and accounting, it was stated that despite the removal of prudence from the Conceptual Framework, the concept remains intact and visible throughout IFRSs and continues to underlie the preparation of accounts under IFRS. If this is so, it is difficult to follow why it was thought necessary to keep out of the Conceptual Framework the reference to and discussion of prudence which had been contained in the Framework.

[27] Although this code contained special capital maintenance rules applicable for public companies, the common law rules prohibiting payments out of capital remain in force (see now CA06 s.851(1)); but these common law rules, which were not such much rules directed at characterising profits as at the principle that in general capital is not to be returned to shareholders, will of course be applied against the modern accounting principles for identifying and valuing assets and liabilities.

(CA80, s.43; now CA06 ss.836 to 840). Although various accounts could in any given case be the relevant accounts, the typical accounts would be the last annual accounts; and broadly speaking these must have been "properly prepared" and have had an unqualified audit report.

31 The concept of realised profits has been much discussed, being of central importance for company distributions,[28] and in due course along with "realised losses" became statutorily defined[29] as *"such profits or losses of the company as fall to be treated as realised in accordance with principles generally accepted, at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses"*.

32 The statutory code, now contained in Part 23 of the Companies Act 2006, for the determination of distributable profits (and thus also for determining amounts which are required to be retained and for maintaining capital), still requires that the relevant accounts, that is the accounts by reference to which the availability or otherwise of distributable amounts is to be determined, must have been "properly prepared" where they are the last annual accounts, or in the case of a public company where they are interim accounts. This, broadly, means prepared properly in accordance with the applicable accounting framework and statutory requirements.[30] And of course the process of determination of distributable profits involves consideration of specific items "*stated in the relevant accounts*" (CA06 s.836(1)). Critically a person using the relevant accounts to make this determination will need to be able to tell what are realised profits net of realised losses.

33 The Guidance Note of 1982 referred to in footnote 28 contained, at paragraph 15, a statement that there was no legal requirement for a company to distinguish in its balance sheet between distributable and non-distributable profits. But the paragraph continued, *"However, where material non-distributable profits are*

[28] See, for example, the Guidance Note, "The determination of realised profits and the disclosure of distributable profits in the context of the Companies Act", issued by the ICAEW in September 1982.

[29] The Companies Act 1989 inserted a new s.742 into CA85, and this new provision by subsection (2) referred back to CA85 s.262(3) (also inserted by CA89).

[30] See CA06 ss.837(2) & 838(4).

included in the profit and loss account or in other reserves which might reasonably be assumed to be distributable, it may be necessary for this to be disclosed and quantified in a note to the accounts in order for them to give a true and fair view". One would suppose that the same principle would apply where distributable profits were not included in the profit and loss account or in reserves reasonably assumed to be distributable. The Guidance Note was recognising that without additional disclosure accounts might not give a true and fair view if they failed to enable a determination of distributable and undistributable amounts.

34 Since 1982, with the statutory requirement for distributions to be by reference to relevant accounts, and with the connection of the definition of realised profits and realised losses being tied to the principles generally accepted with respect to determination for accounting purposes of such items at the time of preparation of the accounts, it is difficult to see how a company's individual statutory accounts could give a true and fair view where they did not contain sufficient information to enable a user to distinguish between realised and unrealised profits and losses and thereby failed to enable a determination of amounts which were lawfully distributable. In my opinion they could not.

35 This, certainly, was the view of the Court of Appeal in *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 at paras [31-2], [2001] 1 BCLC 549 at 556.[31] In that case at issue was whether distributions had been lawfully made, it being argued that they had not been as the relevant accounts had not given a true and fair view and therefore could not be relied upon to justify the dividends. In dealing with the requirement for relevant accounts to give a true and fair view, Robert WalkerLJ, whose judgment the rest of the Court agreed with, explained that the accounting code imposed by the Companies Act avoids difficulty in telling whether a distribution is out of profit or capital, because the accounts should show what is distributable or not. What Robert Walker LJ said was:

> *"[31] The provisions of s.270 are of central importance to this appeal. They ensure that a company's power to pay dividends (or make other distributions within s.263) is linked to and controlled by the very detailed*

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[31] It was also the view of Lord Oliver of Aylmerton given in *Caparo Industries v Dickman* [1990] 2 AC 605 at 630F-G, where he said, "*It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order ... to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital)...*".

codes for accounts laid down by s.226 and 227 and Schedules 4 and 4A. These codes ... represent the implementation of the Fourth and Seventh Company Law Directives ...

[32] The purpose of these directives is (as appear from their recitals and also from ***Tomberger v Gebruder von der Wetten*** *[1996] 2 BCLC 457, 468 (para 17) ECJ) to build on the basic need for "a true and fair view" by requiring a company's financial statements to conform to a uniform layout and terminology and to contain an irreducible minimum of information in the notes to the accounts. In the past it was often, as the Earl of Halsbury LC said in* ***Dovey v Cory*** *[1901] AC 477, 486-7, difficult or even impossible to tell whether a distribution was being paid out of profits or capital. The stringent new accounting code*[32] *avoids that difficulty. As the judge said,*

> *'The statutory code is designed to avoid that difficulty by making it entirely clear on the face of the accounts whether or not a payment of a dividend is properly made. Furthermore the code is designed to be a major protection for creditors and members, as Dillon LJ stated in* ***Precision Dippings***[33]*.'"*

[International accounting standards and the Companies Acts]

36 The IAS Regulation sought to introduce an obligatory uniform accounting framework for consolidated accounts of publicly traded companies, the adoption of the framework being permissive for individual company accounts and for individual and consolidated accounts of other types of company. This framework was to be based on international accounting standards. The IAS Regulation nevertheless recognised the importance of the Fourth and Seventh Directives and their true and fair view requirement. Thus, by Recital 9 it was said (emphasis added):

> *"To adopt an international accounting standard for application in the Community, it is necessary firstly that it meets <u>the basic requirement</u> of [the Fourth and Seventh] Directives, that is to say <u>that its application results in a true and fair view</u> of the financial position and performance of an enterprise – this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives..."*[34]

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[32] The "stringent new accounting code" which Robert Walker LJ was referring to was not the international accounting standards framework (that framework not being available for UK companies for their statutory accounts until after 2004), but that prescribed by the Companies Acts from time to time from 1981 down to 2004.

[33] *Precision Dippings Ltd v Precision Marketing Ltd* [1986] Ch 447 at 455.

[34] The statement that strict conformity with each and every provision was not implicit is a reference to the three ECJ cases referred to above in para 18. These had held that the overriding requirement for a true and fair view permitted departure from specific provisions where not to do so would fail to give a true and fair view. The statement cannot have been intended to suggest that the provisions of

Materially Article 2, which gives power to the Commission to decide on the applicability of international accounting standards, provides by paragraph (2) as follows:

> *"The international accounting standards can only be adopted if:*
> - *They are not contrary to the principle set out in Article 2(3) of [the Fourth Directive] and in Article 16(3) of [the Seventh Directive] and are conducive to the European public good and,*
> - *They meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management*".

37 By Regulation (EC) No.1725/2003 the Commission made the first adoption of certain international accounting standards. From time to time since then there have been further Regulations adopting further standards (including amendments to existing ones). The standards so adopted include IAS 1, referred to by Mr Moore in his Opinion, and also IAS 39 (Financial Instruments: Recognition and Measurement).

[The 2004 Regulations]

38 In 2004 the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004 (SI 2004/2947) made changes to the Companies Act 1985 required to give effect to the IAS Regulation and to permit (or where appropriate require) companies to prepare annual accounts using the international accounting standards framework rather than the traditional Companies Act framework.

39 There were two features of the new regime introduced by the 2004 Regulations which are striking but importantly have not been carried through unchanged into the Companies Act 2006. First, where statutory accounts were prepared in accordance with international accounting standards, the company having chosen (or having been required to chose) that framework, there was no requirement for the accounts to give a true and fair view: the only requirement was for the directors to state that the accounts had been prepared in accordance with international accounting standards (CA85 substituted ss. 226B & 227B). This was to be contrasted

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the Directive could be departed from wholesale or when the application of the provisions was consistent with the giving of a true and fair view.

with the continuing requirement where the Companies Act accounting framework was used: there there was the same overriding requirement for the giving of a true and fair view along with the following of the accounting code set out in schedules to the Act (CA85 substituted ss. 226A and 227A).

40 The second change was in relation to the report to be made by auditors in relation to statutory accounts prepared as IAS accounts. The report had still to say whether the accounts had been prepared in accordance with the requirements of the Companies Act. But as regards the accounts giving a true and fair view, what was to be reported was whether "*the annual accounts give a true and fair view, in accordance with the relevant financial reporting framework*" (CA85 substituted s.235(2)). As to IAS accounts (but not Companies Act accounts) the expression "*true and fair view*" was now defined to mean something specific, namely that the "*requirement under international accounting standards that such accounts achieve a fair presentation*" (CA85 new s.262(2A)(c)).

41 In effect following the commencement of the 2004 Regulations and until those Regulations ceased to have effect[35] a true and fair view in the case of IAS accounts meant simply that the accounts complied with international accounting standards. This follows from the last sentence of paragraph 15[36] in IAS 1. The achievement of a fair presentation is *"presumed*" to result where international accounting standards are applied with additional disclosure where necessary.

42 I should add that the introduction of the definition of what was meant by giving a true and fair view when the accounts in question were IAS accounts also affected the requirement, for the code as to the determination of what distributions could lawfully be made and what would infringe the rules on maintenance of capital, that the relevant accounts should give a true and fair view.

[The present position]

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[35] When in 2008 the material provisions of the Companies Act 2006 were brought into effect.

[36] See paragraph 5.1 above. Para 15 of IAS 1 is important. It is set out in full later in this Opinion, as it was in Mr Moore's Opinion at paragraph 24. At the time, and before later amendments to IAS 1, the paragraph was numbered 13.

43 The Companies Act 2006 reversed the second of the two changes referred to above: the definition (quoted in paragraph 40 above) of "true and fair view" in the context of IAS accounts was removed, and the auditors' reporting requirement became as summarised in paragraph 8.2 above: the relevant requirement (CA06 s.495(3)) is to report:

> *"... whether, in the auditor's opinion, the annual accounts-*
> *(a) give a true and fair view-*
> *(i) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the financial year,*
> *(ii) in the case of an individual profit and loss account, of the profits or loss of the company for the financial year,*
> *(iii) in the case of group accounts, of the state of affairs as at the end of the financial year and of the profit or loss for the financial year of the undertakings included in the consolidation as a whole, so far as concerns members of the company;*
> *(b) have been properly prepared in accordance with the relevant financial reporting framework; and*
> *(c) have been prepared in accordance with the requirements of this Act (and, where applicable, Article 4 of the IAS Regulation). ..."*

44 The first of the two changes was not reversed. Instead CA06 s.393 was enacted. This provides

> *"(1) The directors of a company must not approve accounts for the purposes of this Chapter unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss-*
> *(a) in the case of the company's individual accounts, of the company;*
> *(b) in the case of the company's group accounts, of the undertakings included in the consolidation as a whole, so far as concerns members of the company.*
> *(2) The auditor of a company in carrying out his functions under this Act in relation to the company's annual accounts must have regard to the directors' duty under subsection (1)."*

45 Referring to CA06 s.393 paragraphs 646 and 645 of the Explanatory Notes provided by the government in relation the Companies Act 2006 are in the following terms:

> *"646 Subsection (1) introduces an overarching obligation on directors (the preparers of accounts) not to approve accounts unless they give a true and fair view of the financial position of the company and, in the case of group accounts, the group. This provision reflects the underlying legal duty already expressed in Community law.*
> *647 Subsection (2) in addition places a requirement on auditors to take this overarching duty to give a true and fair view into consideration when giving an opinion on the accounts. This requirement supplements the functions of an auditor set out in section [495]."*

46 The Notes fairly reflect an assumption, to be collected from CA06 ss.393 and 495, that whichever accounting framework is followed statutory accounts produced using the framework can give a true and fair view; that there is nothing in either framework which could dictate a different result.[37]

47 IAS 1 was among the first international accounting standards adopted pursuant to the procedure in the IAS Regulation, being adopted by Commission Regulation (EC) 1725/2003. With time other international financial reporting standards have been similarly adopted. In the process there have been amendments to IAS 1, including in September 2007 the issue of an amended IAS 1, which have been adopted by the Commission.[38] For present purposes, however, there is nothing material in these amendments.

48 I have already set out parts of IAS 1 which deal with the question of "fair presentation". It is this international accounting standard which is the foundation for the assumption referred to in paragraph 46 above. In the light of this it is appropriate to consider carefully what is set out in IAS 1.

49 IAS 1 is concerned with the presentation of financial statements. Paragraph 1 states that it prescribes the basis for presentation of general purpose financial statements, and sets out the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for the contents. After this the material features are as follows:

49.1 After a preamble about its scope and after providing some definitions of terms, the IAS at paragraph 9 describes the purpose of financial statements: "*The objective of financial statements is to provide information about the*

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[37] In debate on the clause of the Companies Bill which became CA06 s.393 the Minister stated that "*... I am aware of the 'fair presentation' language that comes into the IAS requirements, and ... there is no practical difference and that the 'true and fair' principles will still be the key thing that directors and auditors have to consider before they sign off accounts*" (Hansard: Standing Committee D, 13 July 2006, col 685).

[38] Commission Regulation (EC) 1126/2008. Many further amendments to IAS 1 have from time to time been adopted by the Commission, as appears from the consolidated version of that Regulation published by the Commission.

financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions." That paragraph also indicates that the information to meet the objective will be about assets, liabilities, equity, income and expenses (including gains and losses) and so forth.

49.2 At paragraph 15 begins a section headed "General Features", followed by a sub-heading "Fair Presentation and compliance with IFRS". Paragraphs 15 and 16 are as follows (emphasis added):

> *"15 Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the* ***Framework****. The application of IFRSs, with additional disclosure where necessary, <u>is presumed</u> to result in financial statements that achieve a fair presentation.*
> *16 An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes. An entity shall not describe financial statements as complying with IFRS unless they comply with all the requirements of IFRSs."*

49.3 After these two paragraphs paragraph 17 explains that "*in virtually all circumstances, an entity achieves a fair presentation by compliance with applicable IFRS*". But the paragraph adds that a fair presentation also requires an entity to present information in a manner that provides relevant, reliable, comparable and understandable information (this being the formula used in the Framework as a description of useful information: cf para 52 below). Additionally it is said that a fair presentation requires an entity:

> *"to provide additional disclosures when compliance with the speficic requirement in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."*

In other words IAS 1 by paragraph 17 contemplates the possibility of information presented in financial statements being supplemented where otherwise there would be an insufficiency of information.

49.4 Paragraph 19 provides as follows:

*"In the extremely rare circumstances in which management concludes that compliance with a requirement in an IFRS would be so misleading that it would conflict with the objective of financial statements set out in the **Framework**, the entity shall depart from the requirement in the manner set out in paragraph 20 if the relevant regulatory framework requires or does not prohibit such a departure."*

49.5 Paragraph 20 explains what is to be done when an entity departs from a requirement of an IFRS in accordance with paragraph 19.

49.6 Paragraph 23 covers the case omitted from paragraph 19: in the circumstances contemplated in paragraph 19 but where the relevant regulatory framework prohibits a departure from compliance with a requirement in an IFRS paragraph 23 sets out the steps to be taken by way of additional disclosure to mitigate perceived misleading aspects of compliance.

49.7 Paragraph 24 explains what is meant for an item of information to conflict with the objective of financial statements. Again, the paragraph defines the relevant objective as being that set out in the Framework.

49.8 After paragraph 24 IAS 1 sets out certain accounting principles (eg going concern) and manner and time of reporting, before passing to a detailed section headed "Structure and Content".

50 What appears is that IAS 1 requires the provision of supplemental information, where compliance with specific requirements would otherwise give insufficient information for a fair presentation (para 17(c)). This is consistent with Articles 3(4) and 16(4) of the Fourth and Seventh Directives. On the other hand IAS 1 only permits departure from the requirement to present information in accordance with the application of international accounting standards where to present the item of information in accordance with a particular standard would conflict with the objective of financial statements set out in the Framework. Nowhere does it in terms permit departure where failure to do so would prevent financial statements either giving a true and fair view or, indeed, achieving a fair presentation.

51 I have already made reference to the Framework. It defined the all important objective of financial statements (the objective referred to in IAS 1 at paragraphs 15, 19, 23 and 24) by reference to the information needs and expectations of a constituency of stakeholders (for example, investors, employees, lenders etc) likely to read the financial statements. Thus, according to paragraph 12 of the Framework, "*The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions*".

52 The criterion of information being "useful" is defined by the Framework as information being understandable, relevant, reliable and comparable (paragraph 24). Reliability requires, according to the Framework, several qualities (paragraph 31), including materially that the information is a faithful representation of what was depicted (paragraph 33), that it is neutral in being free from bias (paragraph 36), and that prudence is used when exercising judgments in making necessary estimates for uncertainties (paragraph 37).

53 Finally, so far as relevant for present purposes, the Framework contains the following paragraph, paragraph 46, set out in full by Martin Moore QC in his Opinion.

> *"Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an entity. Although this* ***Framework*** *does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information."*

54 I am not as confident as Mr Moore was that at the time of his Opinion (that is 2008) IAS 1 did indeed allow a departure from international accounting standards in any circumstances where the application of a standard would prevent IAS accounts from giving a true and fair view. A departure could only be justified by reference to what was stated in IAS 1; and IAS 1 indicated that the only justification for a departure from the requirements of a standard would be where to follow the requirements of the standard would in the particular circumstances be inconsistent with the objective of financial statements set out in the Framework. That objective was <u>not</u>

that the financial statements would give a true and fair view, nor even that they would achieve a fair presentation, but that they would provide useful information; that is information which had the four listed qualitative characteristics with (in the case of reliability) the particular features mentioned above. Thus IAS 1 did not expressly permit, much less require, a departure from any international accounting standard where compliance with its requirements was incompatible with giving a true and fair view or alternatively of giving a fair presentation.

55 Further, paragraph 46 of the Framework, a paragraph on which Mr Moore placed reliance in reaching his conclusions, has to my mind the appearance of an aspiration rather than any elaboration of characteristics which would make information "useful" so as to form part of the objective set out in the Framework. The proposition stated in the paragraph was that if the requirements of the standards were met that would result in a fair presentation, and would also give a true and fair view. The paragraph did not go on expressly to authorise in terms a departure from the application of any standards where to do so would be required for the financial statements to give a true and fair view. It is not obvious to me how it could be extracted from the paragraph, or anywhere else in IAS 1, as implicit that giving a true and fair view or achieving a fair presentation is a paramount requirement.

56 Nevertheless Mr Moore's Opinion has been widely circulated and no doubt relied upon since it was given. It was published by the Financial Reporting Council on the internet, being available on its website, and has been relied upon by the FRC in its July 2011 publication "True and Fair". According to this publication Mr Moore's Opinion *"confirmed that the true and fair concept remains paramount in the presentation of UK company financial statements, even though the routes by which that requirement is embedded may differ slightly".* Reliance is still placed on it: not only is it still published and commented upon on the FRC's website, but in addition it was recently referred to by the IASBin the submission discussed later in this Opinion.

57 Since Mr Moore's Opinion was given, the Conceptual Framework has superseded the Framework. The objective of general purpose reporting, as stated in the Conceptual Framework, resembles that described in the Framework: it is to provide useful information. However there is a material difference between the Conceptual Framework and the Framework. Now there are two instead of four fundamental

qualitative characteristics prescribed for information to be useful: these are, according to the Conceptual Framework, relevance and faithful representation. As to the latter characteristic, while neutrality is included as an aspect, no mention is made of prudence. Significantly, the Conceptual Framework does not make any reference to the achieving of a fair presentation: there is no equivalent to paragraph 46 of the Framework.

58 While a fair presentation may require a faithful presentation (as stated in IAS 1 para 15), it does not follow that a faithful presentation will result in a fair one. As pointed out above, IAS 1 does not permit departure from international accounting standards simply to achieve a fair presentation where otherwise there would not be one, but only where departure is required to resolve a conflict with the objective of financial statements set out in the applicable framework: if that framework is the Conceptual Framework, the stated objective is that of providing useful information (being for the purpose information with the characteristics identified in the Conceptual Framework), and not of achieving a fair presentation.

59 The short of this discussion, as I see it, is that if properly it is the Conceptual Framework which is to be taken in conjunction with IAS 1, rather than the Framework, then IAS 1 does not provide a route to an overriding requirement in the international accounting standards framework for statutory accounts to give a true and fair view. If, on the other hand, it is still the Framework which is to be taken in conjunction with IAS 1, then there is at least the possibility of an overriding requirement, if paragraph 46 of the Framework serves to equate the objective of providing useful information with that of achieving a fair presentation (and of giving a true and fair view), the view which Mr Moore appears to have taken.

60 At present there may be some doubt as to the document properly referred to in IAS 1. The current version of IAS 1 published by the IASB sets out the text with references to the Framework, rather than to the Conceptual Framework, as indeed quoted above. However, under references to the Framework in the document as printed there are footnotes pointing out that in September 2010 the Framework was replaced by the Conceptual Framework. One of the footnotes (footnote 4) draws attention to the fact that the Conceptual Framework itself replaced the objective of financial statements with the objective of general purpose financial reporting. A

reader of this version of IAS 1 would therefore take it that the relevant point of reference is now the Conceptual Framework and no longer the Framework.

61 On the other hand I am not aware of IAS 1 having been adopted, or having had any amendments adopted, by the Commission to substitute references to the Conceptual Framework for references to the Framework; rather, despite many amendments. the text of IAS 1 as adopted still refers to the Framework for the Preparation and Presentation of Financial Statements (see at para 7, which is plainly referring to the Framework and not the Conceptual Framework). Therefore, as it seems to me, for the purposes of statutory accounts IAS 1 applies strictly speaking as part of the adopted international accounting standards with the relevant reference being still to the Framework and not to the Conceptual Framework.

[The Opinion of Martin Moore QC]

62 Earlier in this Opinion I have referred to the submission made by the IASB in January 2013 to the Parliamentary Commission on Banking Standards' Panel on tax, audit and accounting. At paragraph 13 that submission drew attention to a debate as to whether Mr Moore's Opinion was now out of date, following the replacement of the Framework by the Conceptual Framework. For the reasons given above, the Opinion does to my mind need to be reconsidered.

62.1 If the Framework can still be regarded as operative, being the document referred to in IAS 1 for the purposes of IAS accounts (that is, accounts prepared using the accounting framework of EU adopted international accounting standards), then there will not have been any material change in the landscape since the Opinion was given. The question will be whether it is indeed possible, as Mr Moore considers, to extract from the references in IAS 1 to "the objective of the Framework" a reference to the giving of a true and fair view.

62.2 Otherwise, if the Framework is no longer operative and the references in IAS 1 are to the Conceptual Framework, there will have been a change which would undermine the view that for the purposes of IAS accounts there is an available overriding true and fair requirement; in other words a principle that, where compliance with an international accounting standard would

not give a true and fair view, it is open to a company's directors to depart from the particular standard giving rise to the conflict.

63 The practical importance of this debate is that if a company director whose company is preparing IAS accounts as its statutory accounts and who believes that the accounts so prepared fail to give a true and fair view may not be able to rely on Mr Moore's Opinion, or the statement of the Minister in the debate on CA06 s.393, to permit departure from particular requirements of an international accounting standard which may have been incompatible with the production of accounts giving a true and fair view. The director would be faced with a dilemma. On the one hand his obligation would be to have his company produce its statutory accounts to be laid before the company, and to do this applying international accounting standards where that was the applicable accounting framework; and he would commit a criminal offence if he approved them not believing that they complied with international accounting standards (CA06 s.414). On the other hand he would be faced with the s.393 statutory prohibition against approving accounts which he did not believe to give a true and fair view.

[True and fair?]

64 In paragraph 10 above I set out the questions on which I have been asked to advise. The first of these two questions highlights three areas in which it is said that international accounting standards fall short of what is required for statutory accounts to give a true and fair view.

65 In this Opinion I have not been asked to advise on the accounting outcomes of applying in any case particular requirements of specific international accounting standards. Essentially that would be a topic for accountancy professionals rather than lawyers: were the matter before the Court accountancy expert evidence would be required. My instructions, and this Opinion, proceed on the assumption that accounts may be produced in compliance with international accounting standards but nevertheless because of detailed requirements of one or more or those standards be deficient in respects highlighted in paragraph 10.1 above.[39] The

[39] I have been provided with a note drawing attention to issues connected with specific requirements of IAS 39 and 19. These issues concern loan loss provisions (IAS 39 para 59 and AG88-90); upward fair

assumption also is that the inclusion of additional information in the accounts in accordance with paragraph 17(c) of IAS 1 will not be sufficient to put right the deficiency and result in the accounts giving a true and fair view.

66 The first of the three areas referred to above concerns distributions and capital maintenance. A criticism of international accounting standards is that their application may not result in accounts which will enable the necessary determinations as to distributable amounts to be made for the purposes of Part 23 of the Companies Act 2006, discussed earlier in this Opinion. As to this I have been referred to a paper from the Hong Kong Institute of Certified Public Accountants, as well as a Technical Question and Answer bulletin on the determination of distributable profits. The paper was dated 22 July 2011 and sent by the HKICPA to the IFRS Foundation. In the paper the HKICPA drew attention to what it referred to as the *"lack of linkage between the concept of realisation for distribution purposes and concept of income recognition under IFRSs"*; while the bulletin highlights specific matters in respect of which IAS accounts may recognise unrealised profits and fail to recognise realised profits.

67 In paragraph 12 of her Opinion of 21 April 1993 Mary Arden QC pointed out that while ultimately the question whether any set of accounts give a true and fair view within the relevant provisions of the Companies Act is one of law, to arrive at the answer a court will need expert evidence. What she said was:

> *"... the question whether accounts satisfy the true and fair requirement is a question of law for the Court. However, while the true and fair view which the law requires to be given is not qualified in any way, the task of interpreting the true and fair requirement cannot be performed by the Court without evidence as to the practices and views of accountants ..."*

This view, from a distinguished jurist noted for her company law expertise, has long been accepted as correct. Nevertheless, it does seem to me, for the reasons explained in paragraphs 34 and 35 above, that if a company's individual statutory accounts fail to permit a determination of what is or is not distributable they will not give a true and fair view.

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value adjustment and unrealised profits (IAS 39 para 48 and AG69-AG82); and deferred bonuses (IAS 19 para 126-131).

68 The second of the three areas is that of prudence as a fundamental accounting principle. Given the historic importance of the principle, with its prominence both in the Fourth Directive (and by incorporation in the Seventh Directive) and over many years in the Companies Acts, it would be a seismic shift in the content of the true and fair view concept for prudence to cease to be an integral element. It is one thing for the content of the concept to develop incrementally over time; it is quite another for some elementary feature of what is required for the giving of a true and fair view to disappear almost overnight.

69 The third of the three areas is a particular aspect of the second. Here my attention has been drawn specifically to IAS 39 and to two criticisms of certain requirements set out in IAS 39. The first of these criticisms is that IAS 39 requires in certain cases unrealised gains to be accounted for as profits. So to account for unrealised profits is inconsistent with the particular aspect of the requirement of prudence described in Article 31(1)(c)(aa) of the Fourth Directive (and the equivalent in the Seventh Directive). It is easy to see that, if this is a result dictated by IAS 39, it would involve accounts which fail to give a true and fair view: contrary to prudence the profit and loss account would take account of possible gains rather than profits earned.

70 The other criticism concerns provisioning. The point is made that in IAS 39 in particular, but in general in the international accounting standards framework, provisions may not be made when or to the extent UK GAAP under the Directives would have required. This can have practical consequences, diminishing the efficacy of the capital maintenance provisions of the Companies Act and permitting distributions which would not otherwise have been possible. For example, CA06 s.841(2) broadly speaking requires provisions to be treated as realised losses; but whether and to what extent in any case provisions within this requirement fall to be made will depend on the specific accounting framework within which the relevant accounts are prepared.

[The position of adopted international accounting standards]

71 The problem highlighted by the two questions I have been asked is to decide what the position is if in any case it is found that the application of international accounting standards is incompatible with the giving of a true and fair view. The Fourth and Second Directives might have been expected to have ensured that

domestic legislation preserved in statutory accounts the paramount status of the requirement for the giving of a true and fair view, so that for an entity faced with the incompatibility there should be a clear way out. And the adoption of international accounting standards which generated the incompatibility would have been precisely what the provisions of Article 2(3) of the IAS Regulation, read in the light of Recital 9 of that Regulation, were aimed at preventing.

72 The first of the two questions raises the position of an adopted international accounting standard, where the standard is one which generates an incompatibility.

73 As to this the short point is that in the absence of any permissible true and fair view override the standard will have been one which was not properly capable of being adopted: it will have failed to meet the threshold requirement in Article 3(2) of the IAS Regulation, that in order to be adopted standards must not be contrary to the true and fair view principle[40] which by Article 2(3) of the Fourth Directive and Article 16(3) of the Seventh Directive is required to be encoded in the legislation of Member States.

74 The second of the two questions is one which would need to be considered by a director faced with the prohibition in CA06 s.393, when at the same time his company's IAS accounts prepared in accordance with international accounting standards fail to give a true and fair view. Could the director say in reliance on s.393 and Article 2 of the Fourth Directive that, despite the prohibition in CA06 s.414, without being guilty of a criminal offence he is entitled to approve the accounts subject to a departure from a particular standard where that is necessary for the accounts to give a true and fair view? And will the accounts so approved count as being "properly prepared" for the purposes of Part 23 of the Companies Act 2006?

75 As I have already indicated, in my opinion the second of these two questions is to be answered in the affirmative. If the accounts, as approved by the directors, gave a true and fair view in accordance with CA06 s.393, the Court would be unlikely to find that nevertheless by reason of the departure the accounts were not properly prepared within CA06 s.414 or Part 23.

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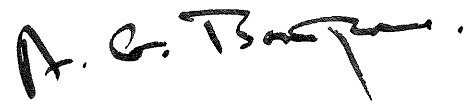
[40] Described in Recital 9 of the IAS Regulation as "the basic requirement" of the Fourth and Seventh Directives.

75.1 In the first instance the Court would look anxiously for some plausible basis for holding that international accounting standards permitted a departure from particular requirements in the cases where that was necessary. To this end it would scrutinise the standards for some way through the difficulty that there is nothing on the face of the international accounting standards which plainly makes such a departure permissible.

75.2 If, on the other hand, there were simply no way of reconciling in the instant case the giving of a true and fair view with compliance with the requirements of some international accounting standard, so that seemingly the accounts while giving a true and fair view nevertheless failed to comply with international accounting standards, then it would be open to the director to challenge the adoption of the particular standard with a plea of illegality in reliance on Article 277 of the Treaty on the Functioning of the European Union, challenging the adoption on the grounds of lack of competence and infringement of an essential procedural requirement: the plea would rest on the failure of the adopted standard to satisfy the threshold condition in Article 3(2) of the IAS Regulation that the requirements of the particular standard should not be incompatible with the giving of a true and fair view.[41]

[**Postscript**]

76 It is unsatisfactory that, in such a fundamental matter as the goal to be reached by those producing statutory accounts, there should be any possible confusion as to the goal. For reasons given in this Opinion I believe that there is that possible confusion.



George Bompas QC

Lincoln's Inn

8 April 2013

[41] An alternative argument would be that the adoption was so obviously flawed that it was a "non-existing act", or in other words a nullity; but the hurdle for such an argument is high, requiring the exceptional displacement of the presumption of validity (case C-137/92 P, *Commission v BASF* para 49).