

[REDACTED]

[REDACTED]

[REDACTED]

1 September 2016

Dear Chairman

**The Financial Reporting Council and Accounting Standards: discharging the contractual and statutory duties of directors – position following a Freedom of Information Act request**

LAPFF wrote to chairmen on 20 November last year setting out that, following the further opinion of George Bompas QC [1], the position of the Financial Reporting Council (FRC) should be disregarded if directors were to discharge their duties lawfully in preparing accounts and making lawful distributions.

The purpose of this letter is to clarify that the government (the Department for Business Innovation and Skills - 'BIS' [2]) has never disagreed with LAPFF. Indeed, had LAPFF's position been incorrect we are sure that the government would have informed us.

Unfortunately, subsequent to the LAPFF letter the FRC made press statements, and issued guidance to companies [3], that have been taken as confirming that the government and the FRC were rebutting LAPFF and Mr Bompas. However, correspondence between BIS and the FRC, obtained under the Freedom of Information Act (FOI), shows that BIS did tell the FRC that it was wrong and BIS had to reject FRC assertions regarding LAPFF's position in no uncertain terms.

The issue at stake is of crucial importance to directors and is as follows.

Mr Bompas is very clear that unless the accounts enable a determination of the distributable profits from the numbers as stated in the accounts, then the accounts will not give a true and fair view of the assets, liabilities financial position and profit or loss. Mr Bompas is also very clear that the law does not permit or require 'two sets of books' to do this. Conversely, the FRC position does require 'two sets of books' because following financial reporting standards can lead to accounts conflating realised profits with unrealised gains, or leaving out losses altogether, with the result that amounts available for distribution cannot be determined from the numbers in the accounts.

This matters because if accounts do not give a true and fair view of the assets, liabilities, financial position and profit or loss, then any distribution will be unlawful, even if the distributable profits existed at the time the distribution was made. On the basis of Mr Bompas' opinion the FRC position creates a significant risk that following the FRC position will be contrary to the law. The FRC position will be particularly problematic for directors if a company later becomes insolvent, or has an unfunded pension fund deficit, after periods in which unlawful distributions were made.

The correspondence LAPFF has obtained shows that on 2 December 2015, the FRC wrote to BIS proposing a press statement with the words in its first paragraph as follows:-

*“The FRC and the government have confirmed that the views of LAPFF on this matter are incorrect and may be disregarded”.*

However, BIS rejected the FRC position saying:-

*“I am very concerned about the wording in the first paragraph. We have never said that the views are “incorrect and may be disregarded”. What we have said is that the Companies Act 2006 does not require the separate disclosure of a figure for distributable profits. Ultimately, whether the views of the LAPFF are incorrect would be a matter for the courts”.*

The FRC then replied with a minor amendment which maintained the incorrect assertion:-

*“The FRC and the government have confirmed that the views of LAPFF on this matter are incorrect”.*

Given that the FRC was still incorrect BIS needed to come back to the FRC again and said:-

*“I really think that this should be kept factual”.*

The correspondence then shows that BIS itself had to rewrite the text excising the reference to LAPFF being incorrect. All that BIS would permit is a position that does not rebut LAPFF or Mr Bompas, which is that: *“the Companies Act 2006 does not require the separate disclosure of a figure for distributable profits”.* [emphasis added]

That position is factually correct - because distributable profits could be more than one line item in the accounts, such as when there are several reserves which are distributable - but neither LAPFF nor Mr Bompas had cause to raise or dispute that point. That point is tangential to the core point from Mr Bompas' opinion which is that unrealised gains and realised profits cannot be mixed up and included as the same item, and that there cannot be ‘two sets of books’ to produce the correct numbers.

The FOI evidence quoted above sets out a documented trail of BIS steadfastly refusing to confirm the FRC's assertion that LAPFF's position is wrong. It also highlights the general risk of the FRC being wrong and providing misleading guidance whenever BIS is not acting to correct it. When we wrote in November we also drew your attention to several FRC publications that have transcribed the words of relevant statute wrongly, which is clearly a first step to misinterpreting it. The FOI evidence also demonstrates the FRC changing the subject in order to avoid addressing the key issue in question.

LAPFF would not have engaged legal counsel, nor written to you, if there were not significant concerns with the FRC and its approach to the law. Indeed, in addition to the problems set out above the House of Commons Treasury Committee has serious concerns too. It said this regarding the FRC in its report of July 2016 into the collapse of HBOS.

*“The Financial Reporting Council (FRC) decided not to investigate the auditing of HBOS in 2013, well before the completion of the final HBOS report. This was a serious mistake. The process by which it reached its decision suggests a lack of curiosity and diligence. These failures are all the more concerning given the scale of the problems at HBOS, and the clear public interest at stake. It is extraordinarily unhelpful that the FRC has taken so long and has belatedly reconsidered its position, only after considerable pressure from Parliament and the Treasury Committee. Following its preliminary inquiries, the FRC has now finally commenced an investigation into the auditing of HBOS.*

*“The auditing of HBOS is the one major element of the HBOS affair that has yet to be subject to adequate scrutiny. The Committee will expect the FRC to undertake an extremely thorough analysis of the HBOS case. Regardless of the outcome of the FRC's investigation process, it is likely that the Committee will want to consider its work and regulatory approach in more detail. The investigation announced on 27 June 2016 is better late than never. But the very tardy response by the FRC appears to be as inexplicable as it is unacceptable.”*

We therefore recommend that you pass this to your lawyers as a matter of urgency. We would also encourage you to have a boardroom discussion. As the FOI correspondence shows, the government has confirmed that it has never stated that LAPFF or Mr Bompas is wrong. Nor has the government said that the LAPFF position creates unnecessary uncertainty. Following the advice of Mr Bompas carries no risk of illegality. It is a safe option, whereas following the position of the FRC carries a significant risk that your accounts will be defective, thus putting your board in a position of approving unlawful distributions, and potentially trading whilst insolvent whilst presenting accounts that show a healthy financial position.

We would be interested to hear of any issues that you might have in applying the law properly as there are significant implications going forwards, for you and your colleagues.

Yours sincerely



Cllr Kieran Quinn, Chair

**Local Authority Pension Fund Forum**

(contact via [sara.hove@pirc.co.uk](mailto:sara.hove@pirc.co.uk) and/or by post to Sara Hove, PIRC, 8<sup>th</sup> Floor, Suite 8.02, Exchange Tower, 2 Harbour Exchange Square, London, E14 9GE):

cc: Company Secretary, [REDACTED]

[1] <http://www.lapfforum.org/Archive/files/BompasFurtherOpinionSignedCopy.pdf>

[2] Now renamed Department for Business, Energy and Industrial Strategy (BEIS)

[3] <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/December/FRC-highlights-key-considerations-for-2015-annual.aspx>