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Accounting failures helped create the crisis, says major pension fund study

London, UK – 1st December 2011 – Flawed accounting standards led UK and Irish banks to overstate their solvency and directly contributed to banking losses of over £150bn, according to the UK's leading shareholder engagement group.

The Local Authority Pension Fund Forum (LAPFF), whose 54 members have combined assets of £100bn, has today published a major study into the failures of UK and Irish banks during the financial crisis. The report, *UK and Irish bank capital losses – post-mortem*, finds that the failure to identify accounting standard setting as a root cause of the initial phase of the banking crisis led to a 'misdiagnosis' of the problem as one of liquidity rather than solvency.

The Forum argues that a relatively simple error was introduced into the financial accounting system in 2005 under International Financial Reporting Standards "IFRS", with severely detrimental effects on financial governance and regulatory oversight. The result of the error was the near collapse of the UK and Irish banking systems.

LAPFF believes that in practice IFRS has run contrary to the 'true and fair' view in accounting, and painted a false picture of the solvency of financial institutions. Banks that appeared to be solvent within a few months required an enormous amount of taxpayer support in order to survive. However shareholders have not, to date, seriously questioned why the weak position of the banks was not flagged in their financial reporting. LAPFF's report is intended to highlight this major fault.

The Forum's analysis shows that the UK and Ireland were at risk because they adopted IFRS more comprehensively than other parts of the EU. As such, they were amongst the hardest hit in the first wave of the crisis. The Forum research estimates that the total loss of capital of UK and Irish banks has been in excess of £150bn, with investor losses even greater.

However, in contrast to popular understanding, the refinancing of the UK and Irish banking systems has been predominantly to make good losses on ordinary lending, rather than investment bank trading book losses.

LAPFF chair Ian Greenwood said: "The failure of several major UK and Irish banks had a major impact on our members in particular, and market confidence in general. Therefore it is vital that we understand precisely what went wrong, including why the failures were initially misdiagnosed as a problem of liquidity, rather than a capital crisis. Our analysis clearly points to the fact that flawed international financial reporting standards played a significant contributory role. This implies that significant reform of both accounting standards and the standard setters is required."

The report is being officially launched at LAPFF's annual conference in Bournemouth today, and the Forum will be talking to other institutional investors about the issues arising from its analysis next week. This will include a significant focus on the need for reform of accounting standards.

A full copy of the report will be made available online through the LAPFF website.

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About the Local Authority Pension Fund Forum

The Local Authority Pension Fund Forum (LAPFF), which was set up in 1991, is a voluntary association of 54 public sector pension funds based in the UK. It exists to "promote the long-term investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate responsibility and high standards of corporate governance amongst the companies in which they invest." The Forum's members currently have combined assets of over £100 billion. PIRC is the Research and Engagement partner to the Forum. www.lapfforum.org

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