Mr Mark Babington
Financial Reporting Council
8th Floor
125 London Wall,
London, EC2Y 5AS

1st September 2020

Dear Mr Babington

International Accounting Standard 1 ('IAS 1') – Invitation to comment - Exposure Draft ED/2019/7 General Presentation and Disclosures

We formally request that you do not issue the letter as currently drafted[1].

The Financial Reporting Council ('FRC') draft response is fundamentally incorrect in law, and in a way that is especially harmful to the parties affected, in particular our member funds as large holders of UK shares in companies as well as the wider public.

Section 393 and the UK endorsement criteria require numbers that do not correspond to the numbers IAS 1 specifies

The Companies Act 2006, at Section 393, states that the accounts cannot be approved unless they *"give a true and fair view of the assets, liabilities, financial position and profit or loss"*.

That is then reflected in the International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019. Those regulations contain the endorsement criteria for the adoption of an International Accounting Standard in the United Kingdom. Section 7(1) of those Regulations states:-

> *"an undertaking's accounts must give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss", and,*
>
> *"consolidated accounts must give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the accounts taken as a whole, so far as concerns members of the undertaking";*

However, draft IAS 1 states (our underlines):-

> *[IAS 1.9] "the role of the primary financial statements is to provide a structured and comparable summary of a reporting entity's <u>recognised</u> assets, liabilities, <u>equity, income</u>, <u>expenses</u> and <u>cash flows</u>, which <u>is useful</u> for….."*

The word "recognised" before 'assets, liabilities, etc' in draft IAS 1 is an encumbrance which is a limitation of scope. It actually creates a perfect excuse for leaving out liabilities or including assets not actually owned. Also, the term "equity" per draft IAS 1 is not the same

[1] https://www.frc.org.uk/getattachment/63ba4720-126a-4557-baa8-0e33f2e2c2a5/General-Presentation-and-Disclosure-DCL-17-07-2020.pdf

as 'financial position' and "income and expenses" per IAS 1 is not the same as 'profit or loss'. A profit or loss is result, whereas 'income and expenses' is merely describing a list of items.

The role/objective of accounts by IAS 1 does not match the Companies Act function

On the second page the draft FRC letter states (our underlines):

> *"We agree with the proposed definition of the role of the primary financial statements and believe that an appropriate balance between comparability and relevance is proposed."*

The Exposure Draft for IAS 1 states, in respect of that role the FRC has agreed with:-

> *[IAS 1.9] The objective of financial statements is to provide financial information about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources.*
>
> *The role of the primary financial statements is to provide a structured and comparable summary of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows, which is useful for:*
>
> *(a) Obtaining an overview of the entity's assets, liabilities, equity, income, expenses and cash flows;*
> *(b) making comparisons between entities, and between reporting periods for the same entity; and*
> *(c) identifying items or areas about which users of financial statements may wish to seek additional information in the notes.*

However, that is not the role/objective of audited Companies Act accounts. The most important function of accounts is set out in Part 23 and Part 18 Companies Act 2006. Those Parts deal with capital maintenance of companies.

The statutory requirements for accounts for capital maintenance purposes are for an essential function (as opposed to merely 'useful') for the accounts of companies for the benefit of companies **themselves**.

In short, IAS 1 is merely establishing accounts to be a 'useful' list of items devoid of any proper context for an indeterminate audience of **'users'**.

The position of the FRC

The FRC should be well aware of these problems between the Companies Act and International Accounting Standards from:-

- the evidence and conclusions of the BEIS Select Committee Inquiry into the Future of Audit[2];

[2] Chapter 3 The Future of Audit, BEIS Select Committee https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf

- the *Asset Co v Grant Thornton* case which came up at that Select Committee, and is set out in the BEIS Select Committee Inquiry into the Future of Audit in paragraph 60 of the Final Report[3];
- and the position of the Competition and Markets Authority, also set in paragraphs 67-69 of the Final Report of the BEIS Select Committee Inquiry into the Future of Audit[4].

We also note that Para 33 of the draft FRC letter states: "*We partly agree with the proposed description of the role of the primary financial statements*". That is not consistent with then saying in the summary on page 2 of the letter "*We agree with the proposed definition of the role of the primary financial statements".*

It is surely time for the FRC to be honest about the fact – as the FRC eventually admitted under the pressure of questioning at the Select Committee Inquiry[5] – that the role/objective of accounts as outlined in International Accounting Standards and the function of the Companies Act 2006 do not match.

We copy the Law Commission as well as the BEIS Select Committee and the Secretary of State.

We had higher hopes of the FRC in the wake of the recommendations of the Kingman Review given that the FRC will be replaced by a new body the Auditing Reporting and Governance Authority ('ARGA').

The linked issue of capital maintenance and going concern were subject to both avoidance and obfuscation by some of the large accounting firms in evidence given to the Future of Audit Inquiry. The sensitivity being that the audit firms carry liability for defective accounts on capital maintenance issues when they are negligent, and that rather than there being an 'expectations gap' there is a delivery gap due to the defective standards regime.[6]

The question from Antoinette Sandbach MP to the Head of KMPG UK during the Inquiry made that clear:

> *"I can understand why you might be shifting shape on this requirement, because of course KPMG was responsible for Carillion paying a £54 million dividend one month before it announced an £845 million hit. The excuse for that has been the accountancy regulations rather than the applicable standards in the company law rules; is that not right?"*

In the Forum's view, the matter of the FRC being a creature of regulatory capture and compromised with the Big 4 accounting firms, is more obvious each time the FRC pursues the wrong path.

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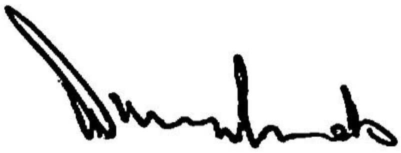
[3] ibid
[4] ibid
[5] Question Q608, The Future of Audit, BEIS Select Committee http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/future-of-audit/oral/96157.html
[6] Para 71-73, The Future of Audit, BEIS Select Committee https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf

It is not acceptable to have the law requiring one thing and the FRC knowingly agreeing to something that is so obviously different.

I am happy to have a meeting. A copy of this letter has been placed on the LAPFF website.

Yours sincerely



Cllr Doug McMurdo

Chair, LAPFF

c/o Alistair Tucker (alistair.tucker@pirc.co.uk) of PIRC, the Forum's research and engagement partner

cc:

Dr Darren Jones MP, Chair the Department for Business, Energy & Industrial Strategy Committee

Sir Nicholas Green, Chair, the Law Commission

The Secretary of State, Department for Business, Energy & Industrial Strategy

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