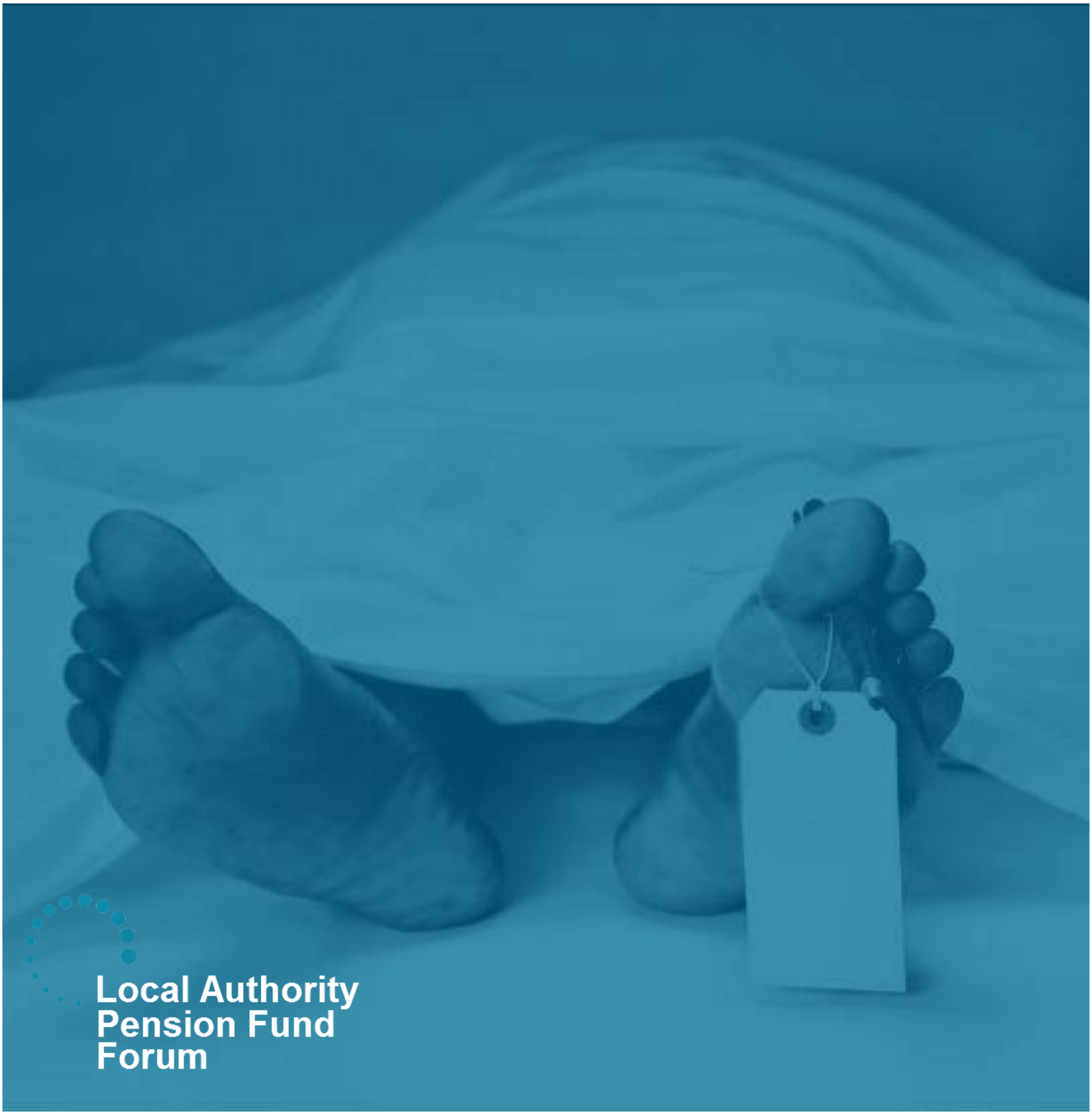
BANKS POST MORTEM – FOLLOW UP



DEC 2013

FOREWORD

In December 2011, LAPFF published 'UK and Irish Banks Capital Losses - Post Mortem' which considered the collapse of the capital adequacy regime of banks in the UK and the Republic of Ireland. These two jurisdictions have common accounting standards in terms of UK/Irish GAAP and have a similar method of implementation of International Financial Reporting Standards (IFRS).

It was clear from the LAPFF analysis that the Basle capital adequacy regime failed due to the systematic failure of the accounting standards regime which should have been underpinning banking company solvency. In large part this was due to a backward looking loan loss provisioning model that made sub-standard lending appear highly profitable. French banks in contrast used prudent French GAAP which does not mask insolvency.

Since then, the UK side of LAPFF's analysis has been fully supported by the outcome of the Prudential Regulatory Authority's (PRA) review in late Spring 2013, which addressed the overstatement of bank capital, including systemic IFRS overvaluation of loans.

The methodology used by the PRA in its review was similar to that of the LAPFF analysis. They both provided a number for future likely losses not covered by IFRS and that the Basle Regime was also not picking up as it was only looking at 50% of one year's expected losses.

LAPFF has since met with representatives of European central banks as well as Japanese government representatives, and the analysis and conclusions of the Banks Post Mortem have not been challenged.

The impact on the main listed UK banks of capital losses are quantified in the Post-Mortem document. However LAPFF also notes that at the time of its Q3 2013 financial results statement, Royal Bank of Scotland is still expecting more than £4 billion of losses that it is not booking in its accounts. The losses in its Ulster Bank subsidiary alone are now over £15 billion.

The PRA review also picked up problems with Co-op Bank that were large enough to wipe out the entire capital of the bank but that were not reflected in its accounts. That is now the subject of individual Parliamentary and other enquiries.

Audited annual accounts were first required by the 1879 Companies Act, following the collapse of the City of Glasgow Bank in 1878 due to a long standing fraud that overstated the bank's reserves. Today it is clear, as LAPFF's own work has demonstrated, that both the accounting standards regime and auditing practice has come adrift from the statutory framework of accounts under company law.

The International Accounting Standards Board has been pursuing a model that is not only alien to that framework, but also one which had twice been expressly ruled out by Parliament due to its not dealing with issues relevant to the company being a going concern or not.

The true and fair view, in UK law since 1947 and EU law since 1978, is the overriding standard for accounts to comply with company law. However in the route to adoption of IFRS, 'true and fair view' has been portrayed as if it meant something else. That something else being "complying with standards" and in a "Framework" that in LAPFF's view is at odds with the basic requirements of company law. What is thence missing from the "imposter" true and fair view is solvency and going concern based on properly stated capital and reserves, as well as lawful distribution of profits based on properly accounted for profits, capital and reserves.

Through the Autumn of 2012 and the Spring of 2013 LAPFF worked closely with a consortium of other asset owners and managers including USS, Railpen Investments, Royal London Asset Management, Sarasin Partners, Governance for Owners and the UK Shareholders Association to track down the origin and causes of this fundamental weakness in the way IFRS had been implemented and were actually operating in the UK capital market. This consortium, known as the IFRS Investor Coalition, pooled their knowledge and experience together to seek independent redress of the problems identified.

In the summer of 2013 LAPFF, together with the Investor Coalition, sought Council's Opinion to advise on the consistency between International Financial Reporting Standards and the Companies Act 2006 and this Opinion from Mr George Bompas QC was submitted as evidence to the Parliamentary Commission on Banking Standards, which was published on 19 June 2013 in the Commission's final report.

That Opinion cast doubt about the requirements under IFRS compared to the law applicable under the Companies Act 2006. Mr Bompas also addressed whether Martin Moore QC's Opinion in 2008 for the FRC (Financial Reporting Council) could be relied upon.

Mr Moore has since responded on behalf of the FRC in October 2013. A detailed analysis of that response is provided later in this document. However LAPFF notes the following-

- The Moore response is in the form of a statement, it is not given the title of an 'opinion',

- In the Moore statement, Mr Moore still does not state whether in his opinion IAS 1 both requires and permits an override of an IFRS that does not give a true and fair view - without qualification to extraneous material, such as referring to other 'frameworks' that are not actually company law,

- Every question that Mr Bompas was asked and responded to (para 10 of the Bompas Opinion) has been changed materially in the Moore statement (para 23 of Moore 2012) by words being left out, changed and in one case an entirely different question altogether being presented,

- The Moore statement also opens up a new dispute with Mr Bompas' position on a specific point of law. The point of law is whether companies should be **showing**, as distinct from accounting for privately, distributable reserves and profits versus undistributable reserves and unrealised profits. LAPFF notes that a failure to show such reserves and profits creates problems:-

    - It is inconsistent with explicit auditor duties in the Companies Act, including their duty to be passing an opinion on the distributable profits as stated in the accounts, the point on which the FRC has explicit guidance,

    - It is inconsistent with the explicit requirement in the Companies Act that auditors cannot sign off on accounts where the numbers in the accounts are not in agreement with the underlying records, and unless they state that fact, they are guilty of a criminal offence,

    - It cannot be explained by the construction of the 1947 Companies Act where 'true and fair view' is explicitly the legal standard to satisfy both internal control requirements ('the books') as well as for the annual accounts.

- LAPFF notes that the only authoritative basis cited by Mr Moore for a difference of opinion with Mr Bompas is from technical advice from the Institute of Chartered Accountants in England and Wales (ICAEW) which Mr Moore had reviewed for the ICAEW. However it does not address the problems above and no formal opinion seems to exist for it. The Moore position is different not only to that of Mr Bompas but also to Mr Bompas' citation of very clear case law.

The FRC statement of Baroness Hogg on 8 October 2013[1] is a positive step and is a partial concession that something indeed has been very wrong. However, the fact remains that five years on from the banking crisis, investors are still not receiving adequate information from the annual accounts, nor assurance from auditors, and this appears to be due to the accountancy profession and standard setters operating to a different model to that of the law.

LAPFF is still of the view that until there is an independent enquiry into the failures of the IFRS standard setting and adoption process, matters will not be settled within an appropriate timescale. The consequences of faulty accounts not discharging solvency duties under the Companies Act create too many conflicts for the various parties involved, particularly when the companies involved are as large as banks.

LAPFF continues to consult legal advice with regard to these matters.

Councillor Kieran Quinn, Chairman Local Authority Pension Fund Forum

[1] http://frc.org.uk/News-and-Events/FRC-Press/Press/2013/October/Accounting-standards-are-part-of-legally-binding-c.aspx

PRA NUMBERS OF MAY 2013

£ billion	Barclays	Co-op Bank
Losses not booked	8.6	1.5
Capital resources	40.7	1.7
Loss as %	21%	88%*
	Nationwide	**RBS**
Losses not booked	0.4	7.1
Capital resources	4.3	37.2
Loss as %	9%	19%

£ billion	HSBC	Lloyds BG**
Losses not booked	7.8	12.1
Capital resources	77.6	28
Loss as %	10%	43%
£ billion	**Santander UK*** **	**Standard Chartered**
Losses not booked	0.7	0
Capital resources	8.5	20
Loss as %	8%	0%

* Note that the losses in Co-op Bank were of such a scale it was not deemed to be a going concern. Since then the bank has been subject to restructuring with a cash injection of £400 million from Co-op Group (which required asset disposals) and a conversion of bondholder interests into equity, which has resulted in the loss of control of Co-op Group over the bank.

** Lloyds TSB acquired HBOS Plc.

*** Santander acquired the failing Alliance and Leicester Plc.

BACK TO BASICS – WHAT STATUTORY ACCOUNTS ARE FOR

For UK and Irish banks there has been a significant drift from the most basic requirements of the law under the assumptions underpinning the IFRS system.

We set out these fundamentals as follows:

- It is illegal for a company to distribute from capital, putting the shareholder interest (in a loss making company for example) ahead of the creditors. With false accounts it is more likely that situation may occur.
- It is unlawful to trade whilst insolvent, and unsettling the creditors itself can cause withdrawal of support (leading to the company no longer being a going concern).
- Shareholders wish to assess the progress of their investment, including whether directors are discharging their duties properly. This is dealt with by **the accounts** at the Annual General Meeting. That too requires knowing whether the company is truly profitable or not. It is also relevant to subscribing new capital.
- The law then requires that the power for any company to make a distribution requires **the annual accounts** (bar two exceptions) which are subject to audit for all large and public companies.
- The law is explicit that the auditors are passing an opinion on the distributable profits **as stated in the annual accounts**. So are model audit reports of the Financial Reporting Council (FRC) for the UK and the Institute of Chartered Accountants in Ireland (ICAI) for the Republic of Ireland. IFRS is objectively not delivering that.

PROBLEMS WITH IFRS AND COMPANY LAW Pt II

An analysis of the response of Mr Martin Moore QC of October 2013 to the Opinion of Mr George Bompas QC of April 2013

i. The general problem with IFRS

Moore has not answered the question as fully as Bompas has:

Bompas raised the question of International Accounting Standard (IAS) 1 and the IFRS Framework (a document referenced from IAS 1) not **requiring** and **permitting** overriding an IFRS standard to give a true and fair view

True and fair view Bompas cannot read **both** a permission and a **requirement** to override an IFRS standard that does not give a true and fair view.	Moore 2013 is not fully answering the question as to whether **the** override in IAS 1 is both requiring and permitting overriding an IFRS that does not give a true and fair view. Moore refers to **an** override instead. The use of the indefinite opens up scope for a different outcome. One such outcome is any definition of **accounting purpose** in the IFRS Framework that does not correspond to the **legal purpose** in company law, which is linked to **capital maintenance**. Capital maintenance being the legal basis of accounts dealing with the interlinked matters of lawful profits, solvency and going concern.

Which Framework? Bompas believes that it is the old IFRS Framework that is EU adopted via IAS 1 not the new Conceptual Framework.	Moore also confirms that it is the old IFRS Framework that is EU adopted via EU-IAS 1 not the new Conceptual Framework. He also confirms that prudence is an overriding requirement of IAS 1 and the old IFRS Framework. **However** that is still subject to the qualification of being by reference to the "Objectives of Financial Statements" set out by the IFRS Framework.
Scope limited by the Framework? Bompas clearly ties the objective of the true and fair view in company law, with capital maintenance. He does not limit its scope.	That the objectives of IFRS are different to the objectives of Company Law come through Moore's answers in several respects.

In summary: Moore's answers do not explicitly deal with capital maintenance as an objective for the accounts to deliver and which the true and fair view test is the overriding standard. That is Moore is not dealing with true and fair view as a standard of financial governance but as some form of third party 'usefulness' instead. An accounting standard should be capable of delivering both a true and fair view and usefulness, but an accounting standard should not be trading off true and fair view for some other test of 'usefulness.

ii. Answers to the four specific questions Bompas was asked

Moore has changed every question Bompas was asked and hence not answered the same questions:

Bompas was asked four questions (10.1.1, 10.1.2, 10.1.3(i) and 10.1.3(ii)) on which his Opinion is then based. **Moore has transcribed every question in a way that makes the question materially different.** He has changed things by a combination of leaving words out and changing words, and in one case, changing the question entirely.

Incurred loss problem Bompas is clear that the problem caused by applying IFRS in banks should be overridden to deal with *foreseeable liabilities and likely losses*. This is then referenced to problems with the statutory capital maintenance regime. **Bompas 10.1.3(ii)**	**Incurred loss problem.** Moore has not answered the question by changing it to '*provisioning approach'.* His answer then addresses '*speculative and hypothetical'* losses. That was not what Bompas was asked nor answered to. **Moore Para 23(c)(ii)**
Prudence The general application of prudence **Bompas 10.1.2**	**Prudence** Moore has not answered the question by leaving out the references in the question to European Court of Justice (ECJ) Additionally Moore is not addressing prudence in valuations (as distinct from not booking unrealised profits) by having dropped the word '*valuation*' from his version of the Bompas question. **Moore Para 23(b)**

Not distinguishing between realised profits and unrealised profits (the mark to market problem) **Bompas 10.1.1** **Bompas 10.1.3(i)**	**Not distinguishing between realised profits and unrealised profits** (the mark to market problem) Moore completely changed the question. That then led to a response to a different question giving scope for considerable disagreement which the Department for Business Innovation and Skills (BIS) minister then recited. **Moore Para 23(a)**
	Later, Moore does tackle the actual issue head on and disagrees with Bompas' reading of the statute and citation of the Queens Moat case law and Lord Oliver in Caparo. Moore invokes ICAEW Guidance from 2010 as evidence of an acceptable approach. Moore does not state that he had reviewed this guidance for the ICAEW. i.e. Moore is relying on something that the accounting profession has also been relying on him for. **Moore Para 23(c)(i)**

One problem with the approach of Mr Moore on realised and unrealised profits is that the approach is not only contrary to the opinion of Mr Bompas and the cases Bompas cites, it is also contrary to what the FRC's model audit reports state, and the Bulletin that goes with them.

The Moore approach would also allow for the books and the accounts to show different numbers when Section 498(2) CA 2006 makes it a duty of auditors to state in their reports if that is the case. However, this has not been occurring in practice.

iii. Reluctance to address overriding IFRS where it is deficient

Moore's answers are inconsistent with what might appear to be his conclusions in I. above.

If Moore was agreeing with Bompas on IAS 1 (having an override that permits and requires overriding an IFRS that does not result in a true and fair view) then:-

- Moore's answer in para 13, would not be needed. There would be no need to go to the European Court of Justice to overturn a defective IFRS. IAS 1 would be able to do it.
- ICAEW Guidance would not be needed, as in para 40 of Moore 2013. Unrealised and realised profits would not require calculations lacking transparency as set out in the ICAEW approach. The overriding requirement for a true and fair view would provide that disclosure in the first instance by means of an override in IAS 1.

Similarly if Moore was agreeing with Bompas on Section 393 Companies Act taking precedence over IFRS, the same would apply as above. ICAEW Guidance would not be needed.

Further, Moore, unlike Bompas, does not deal with the fact that auditors have no dilemma in dealing with both Section 393 (not to approve accounts that do not give a true and fair view) and the requirement to prepare accounts that comply with IFRS (which might not). The auditors merely have to pass an opinion on whether each condition is met or not.

iv. Answers To The Questions From Bompas In Depth

IAS 1 and the IFRS FRAMEWORK

Bompas	Moore 2013
IAS 1 and the Framework Bompas (paras 54-55) was critical of the Moore 2008 Opinion regarding Moore's reading of IAS 1 and the Framework.	**IAS 1 and the Framework** Moore does not fully answer the questions posed by Bompas. His answer is also contradictory to the then FRC/BIS position.
Bompas cannot see a **permission** and a **requirement** to override an IFRS to give a true and fair view or fair presentation where following an IFRS standard does not give it. Bompas challenges Moore's reading of IAS 1 and the Framework on both points. Bompas (para 8.1) identifies the dilemma of the directors if the requirement to **prepare** accounts under IFRS (with no IAS 1 override) results in an outcome that is not giving a true and fair view when by S393 of the Companies Act, Directors can only **approve** accounts that give a true and fair view. Bompas then in para 8.2 states that the auditors do not have a dilemma, i.e. prepare on one basis and approve on another, as they merely have to give two opinions.	Moore concludes that the override in IAS 1 "*does not use the direct language that would satisfy Mr Bompas"* (paras 70-82). But Moore still does not actually answer the question whether the override in IAS 1 is one that both **requires and permits** overriding an IFRS to a true and fair view. That this is the case is betrayed by para 13, where Moore says that a director is **'entitled'** to follow EU IFRS standards as adopted, without overriding them, whether with IAS 1 **or Section 393**. Moore refers to having to use the ECJ to override an IFRS. Moore has sidestepped dealing with the dilemma. Further, 'entitled" is an odd word to use and does not actually mean that it is correct to do so. It may well be a form of defence "I followed the standards" even though doing so did not lead to the correct outcome. It may also relate to the fact that directors relied on Moore's 2008 Opinion, i.e. that Moore considers that they were entitled to rely on it. Moore also completely fails to deal with the auditor position.
Bompas is clear that the new Conceptual Framework does not require or permit an override of an IFRS to give a true and fair view or fair presentation. Bompas is clear that only IAS 1 with the old Framework, not the new Framework, has been EU adopted.	Moore confirms that IAS 1 adopted by the EU is with the old not the new Framework. *'the version of IAS1 adopted by the EU refers to the 2001 Framework, and that version has not been amended to refer to the Conceptual Framework. As a result, there can be no debate as to whether 'prudence' has been, and remains now, a component of a true and fair view (or fair presentation) for the purpose of determining the application of the override in IAS1, paragraph 19*"**.** Moore then says in para 61 that the new Framework should contain prudence for any **new standards** created under it to be endorsed. However, Moore seems to be opening up the possibility that **any IFRS already adopted under the new Framework** (which are not using prudence) might not have been properly endorsed.

Both the **FRC and BIS** are clearer than Moore that the Companies Act (CA) 2006 Section 393 takes precedence over IFRS. They are also silent on the position of the auditors.

NB: it is clear from some evidence submitted to Parliamentary Commission for Banking Standards that some Big 4 firms have been assuming that the new Conceptual Framework applied merely because the IASB, rather than the EU had adopted it.

Question 1

Bompas	Moore 2013
Capital maintenance purpose of accounts	Does not answer the question by changing it entirely, thus creating a new one to then disagree with
Q 10.1.1 *"The **failure of IFRS to include the capital maintenance purpose <u>of accounts</u>** 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[2], for which giving a true and fair view is the required standard."*	Para 23(a) *"IFRS fail to include the capital maintenance purpose of which reserves are distributable or not"* Bompas was not asked which reserves are distributable or not (e.g. whether the share premium and/or merger reserve are tagged in the accounts for that attribute). The question was IAS 39 not accounting for realised versus unrealised profits. The revised wording Moore uses has strange grammar and the words 'of accounts' are also missing. Then Moore does deal with matters of distributable profits (paras 29-40) in some depth (but never capital maintenance – which is broader than distributable profits, e.g. going concern) **(see Section A – distributable profits).**

The BIS Ministerial statement runs with the question that Bompas did not ask. That leads to the hyperbole that if Bompas is correct that most accounts will have been unlawful for the last 30 years.

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

Question 2

Bompas	Moore 2013
Prudence generally	**Prudence generally** Moore does not answer the question by leaving 2/3rd of it out.
Q 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 Forth 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)."***	**Para 23(c)** *'IFRS fail to require prudence as a fundamental accounting principle'. END.* Moore thus cuts any reference to the ECJ cases from the question. There is then no reference to the ECJ cases in Moore's answers. Related to this in **Para 59** Moore says '*The Court would not be bound by some historic view of prudence'.* Having not addressed the matter of the ECJ cases, this statement would also seem to rule out any Court looking back. However, English Courts are bound by case precedent. The ECJ is not '***bound***' in the same way as English law, but the ECJ does refer to cases. Moore has thus managed to avoid any reference to the cases that the ECJ would consider. Nor has he considered whether English Courts would also find the ECJ cases compelling.

The **FRC** would like prudence back in the Conceptual Framework, although it is not clear by what definition of prudence.

Question 3.1

Bompas	Moore 2013
Mark to market valuations and profits	Moore does not answer the question by a very slight change leaving out the word '**valuation'**.
Q 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.*	*Para 23(a)(i) "The* ***failure of individual IFRS to follow statutory accounting principles****, including in particular:-* *IAS 39 allowing unrealised mark to market or mark to model profits contrary to the requirement of prudence to include only realised profits required under Article 31(1)(c) (aa) of the Fourth Directive* Moore is then dealing with realised versus unrealised profits (see **Section A – distributable profits).** Also, by leaving out the word 'valuation' the question of the reliability of the balance sheet with IAS 39 has not been addressed.

The FRC goes further than Moore, and the statement from Baroness Hogg is clearly calling for mark to market movements to be shown.

Question 3.2

Bompas	Moore 2013
Incurred loss problem	**Incurred loss problem** Moore does not answer the question by changing it.
*Q 10.1.3 The **failure of individual IFRS to follow statutory accounting principles**, including in particular:-* *(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) or the Forth Directive, and the equivalent requirement of the Seventh Directive".*	In Para 23(c) (ii), Moore has written the question Bompas answered differently *"In IAS 39 and others in the **general approach to provisioning** contrary to Article 31(1)(c)(bb) or the Forth Directive"* Having changed the question, Moore then **in Para's 62-69** does not answer the question on foreseeable and likely losses. Instead in Para 67 he says *"The consequences of future events that are speculative or hypothetical are not required to be recognised."* Bompas was not saying that there should be accounting for losses on speculative and hypothetical events, he answered to 'foreseeable' and 'likely' (as do the ECJ cases)
The FRC and BIS position is silent on this issue also.	

Section A – distributable profits

i. Moore's/ICAEW interpretation of Section 836 CA 2006 – creates incongruities within the same section.

Section 836 CA 2006 is attached at the end of this document as an Appendix. If Mr Moore's interpretation is correct, that Section 836 us justifying showing items such as 'profits' as amalgamated subtotals, then the first line does not actually mean **determine** by what is stated in the accounts, because another calculation is needed.

For the interpretation:-

- 'profits' in Section 836(1)(a) is describing a sub-total including both realised and unrealised profits, and.
- 'Share capital and reserves (including undistributable reserves)' is also a sub-total causing realised and unrealised reserves to be indistinguishable,

i.e. all of Section 836(1) is merely describing sub-totals, not the underlying items being described. However there are other consequences of the interpretation:-

- Section 836(1)(b) – 'provisions' is incongruous by that model. Provisions can be in the form od both assets (e.g. depreciation) and liabilities (a provision for a future liability). 'Provisions' do not exist as a sub-total:-
- Further to that, provisions against an asset only shows up in the accounts if the assets to which that is applied are shown, e.g. depreciation against fixed assets or a provision against inventory. That model is inconsistent with 'assets' being a subtotal, rather than a description of the disclosed underlying items.

Consequentially, the argument that 836(1) is describing sub-totals breaks down, even when trying to apply it consistently within the same subsection of the Act.

ii. Moore's/ICAEW reading of Section 836 – creates inconsistencies with the next clause Section 837 and the FRC Guidance for Auditors on the 2006 Companies Act

The Auditing Practices Board (FRC) has a published Bulletin[3] setting out the requirements of Section 837, CA 2006. That document makes it clear that if an auditor qualifies his report there is doubt as to whether his opinion is still covering **the distributable profits as stated in the accounts.** The model audit reports of ICAI (Irish Institute) are similar.

Further, as referred to by Mr Bompas, this is also contrary to the auditor duty of care set out in Caparo (House of Lords 1990).

iii. Moore's/ICAEW reading of Section 836 – creates another problem for the auditors by Section 498(2)

The ICAEW proposition that the underlying records to discharge Section 836 (to account for distributable and undistributable profits), but without showing them, will create a mismatch between what the accounting records show the profits to be and what the accounts show.

However Section 498(2) is clear that if this is occurring (i.e. there are 'two sets of books') the auditor has to state so in his report. If the auditor does not do that, by Section 504, he is guilty of a criminal offence.

iv. Moore's/ICAEW interpretation of Section 836 CA 2006 – creates incongruities with the 1947 Companies Act where 'true and fair view' is first introduced in to UK law (and then later EU law)

True and fair view appears in two sections of the 1947 Companies Act:-

- Section 12: True and fair view is the standard for the company to keep the books of accounts, for which the directors (to discharge their duties) should have access at all times, then

- Section13: True and fair view applies as the same standard for the annual accounts.

On the legal principle that legislation means what it was first passed, and given that by Section 12 and 13, true and fair view is a standard which includes what the directors must have access to, to discharge their duties (solvency distributed profits etc.), it is difficult to see how by 2006 true and by 2006 true and fair view can have changed to mean something else. Certainly by the case law in Queen Moat 2000/01 it has not changed from 1947. Nor can it have by the reasons set out in i)-iii) above.

[3] Ref Miscellaneous Reports By Auditors Required by the United Kingdom Companies Act 2006

Section B - Other instances where Moore has changed what Bompas said to convey a different message

Moore 2013 states…	Bompas actually said…
Bompas on 1982 ICAEW Guidance	
Moore says:- *"Mr Bompas does not dispute the proposition in guidance that there is no legal requirement for a company to distinguish in its balance sheet between distributable and non-distributable profits – a proposition that has been repeated in the 1982 Guidance Note and its successors"*	However Bompas did not need to dispute it because Bompas then said "*But the paragraph continued"*. This is what Bompas said:- *"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.*** *<u>But the paragraph continued,</u> "However, where material non-distributable profits are 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."* Also of note is that the 1982 Guidance note actually said "no legal requirement as such". That is odd wording, but is consistent with it being incumbent in the legal requirement for a true and fair view.

Section C – Moore avoids dealing with capital maintenance and group accounts

In his responses to all of the questions (10.1.1-10.1.3) Moore is also leaving out reference to the 7th Directive on group accounts.

Whilst distributions are lawful by reference to the profits and financial position of the company's (including its subsidiaries) unconsolidated accounts, group accounts do have a bearing on the capital position of the parent company. This might be due to any one or a combination of the following:-

- If a parent company has guaranteed a subsidiary's loans, then losses in a subsidiary may transfer to the parent company. The consolidated accounts should show this, and this may have a bearing on the numbers in the balance sheet and profits and loss account of the parent company.

- Parent companies may have economic exposure to losses in subsidiaries due to either the value of the investment in the subsidiary, or intercompany loans to the company being affected.

- The going concern of the parent company depending on the going concern position of the group as a whole.

Therefore the principle in the Directives that the true and fair view of the group accounts of a parent company is the same as that as if the group were one legal entity, does bring in profits and reserves on that basis. The model of the Directives is prudently assuming that the veil of incorporation is broken. This is particularly relevant for financial services groups where support within groups is required by EU Directives exactly on that basis.

It is also relevant that parent company dividends, whilst paid out of parent company profits, are usually justified by reference to group profits for dividend cover purposes. The Queens Moat judgement covers this aspect.

This is then consistent with Moore's position in Para 23(c)(ii) where he has dropped the word 'valuation' in transcribing Bompas' question. Imprudent valuations are not merely a distribution issue; they may be an issue affecting going concern. Prudent valuations support going concern. As distributions are usually paid in cash, hence the valuations affect the stability of what remains in the parent company and group.

APPENDIX

Section 836 of the 2006 Companies Act
Justification of distribution by reference to relevant accounts

(1) Whether a distribution may be made by a company without contravening this Part is determined by reference to the following items as stated in the relevant accounts—

(a) Profits, losses, assets and liabilities;

(b) Provisions of the following kinds—

(i) Where the relevant accounts are Companies Act accounts, provisions of a kind specified for the purposes of this subsection by regulations under section 396;

(ii) Where the relevant accounts are IAS accounts, provisions of any kind;

(c) Share capital and reserves (including undistributable reserves).

Section 831(4) A company's undistributable reserves are—

(a) Its share premium account;

(b) Its capital redemption reserve;

(c) The amount by which its accumulated, unrealised profits (so far as not previously utilised by capitalisation) exceed its accumulated, unrealised losses (so far as not previously written off in a reduction or reorganisation of capital duly made);

(d) Any other reserve that the company is prohibited from distributing—

(i) By any enactment (other than one contained in this Part), or

(ii) By its articles.

Section 830 Distributions to be made only out of profits available for the purpose

(1) A company may only make a distribution out of profits available for the purpose.

(2) A company's profits available for distribution are its accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made.