

Mr Theodor Dumitru Stolojan MEP  
Chairman of ECON Working Group on IFRS  
The European Parliament  
Brussels  
BELGIUM

31 August 2015

Dear Mr Stolojan

**International Accounting Standards (“IAS” and “IFRS”) – and conflict with the law regarding the true and fair view requirement**

The Local Authority Pension Fund Forum (LAPFF) represents the interests of 65 UK public sector pension fund members with combined assets of approximately €235 billion.

LAPFF has been concerned that the European Financial Reporting Advisory Group (EFRAG) did not have appropriate criteria for assessing IFRS for the ‘true and fair view’ requirement of European Union law in adopting these standards. LAPFF is pleased that this concern was supported by the Commission Staff paper of 18th June 2015 on the functioning of the IAS Regulation.

Because achieving a true and fair view is the fundamental legal test, in the IAS Regulation 2002, that an IAS standard has to reach in order to be adopted for use in the EU, the EFRAG process on IFRS 9 (indeed all IFRS) has been fundamentally flawed on process, as it is acting contrary to the requirements of the IAS Regulation and is leaving the adoption of IFRS open to challenge.

LAPFF has therefore taken the unusual step of seeking Queen's Counsel opinion, from Mr George Bompas QC, a senior advocate and judge, as LAPFF did not accept the position of the Financial Reporting Council and its legal counsel when it made various statements about ‘true and fair view’, IFRS and the law.

We include with this letter the full Opinion of George Bompas QC dated 14<sup>th</sup> August 2015 (“Opinion”) as it raises substantive points of law, not merely contrary to the position of the FRC but also explaining where the FRC has gone wrong.

LAPFF’s independent approach has far reaching consequences because the ‘true and fair view’ requirement of European law has its origins in UK law and decisions of the Court of Justice of the European Union have confirmed its equal applicability across member states. Therefore any defective legal position taken by the FRC will not only have wrongly justified the FRC’s position in the UK and Republic of Ireland, but it will also have misinformed the position of EFRAG, as well as the Commission, for the whole EU.

## The core problems

The Opinion identifies three core problems:

- IAS 1 and the IFRS Framework (despite what has been purported by the FRC and its counsel and followed by EFRAG) does not permit or require an overarching obligation to give a 'true and fair view' but something different, so-called "usefulness", that does not equate to this<sup>1</sup>,
- nor does that sub-standard objective of IFRS attach to the precise matters required of EU law, being the profit (or loss), assets, liabilities and net asset position as specific numbers in the accounts<sup>2</sup>. The IFRS system instead applies its vague "usefulness" standard to basically anything in the accounts,
- the Opinion is also clear that if the accounts of a company do not enable a determination of distributable profits as stated in the accounts, which is a central purpose of accounts in law, then the accounts will not give a true and fair view<sup>3</sup>.

The result of this is that the current position of IAS 1 and the IASB's Framework is defective. Also the proposed endorsement of IFRS 9 would be defective because the form of fair value accounting in IFRS 9 does not enable a determination of distributable profits because unrealised mark-to-market and mark-to-model gains are mixed up with realised profits. This also means that the adoption of IAS 39 was defective.

## The source of the problems

The Opinion sets out how the problems flow from misreading legislation and applying false logic.

The Opinion states that, in coming to its defective position on true and fair view and distributable profits, **the FRC's legal counsel** was relying on defective advice produced by **the Institute of Chartered Accountants in England and Wales (ICAEW) and Institute of Chartered Accountants of Scotland (ICAS)** from 1982 (i.e. the accountancy profession<sup>4</sup>). The ICAEW/ICAS position according to Mr Bompas *'is simply not what was provided for'* by the legislation in place then or now.

On IAS 1 the Opinion states that *"the logic deployed by Mr Moore [FRC legal counsel] is defective"*<sup>5</sup>. This is because IAS 1 and the IFRS Framework neither requires nor permits a true and fair view (or fair presentation) as the overarching objective for particular numbers specified in the accounts. The overriding obligation of IAS 1 and the Framework is merely information that is 'useful'. Many things can be 'useful' and the FRC and Mr Moore are wrongly equating 'usefulness' (the objective of IFRS) with 'true and fair view' (the objective of EU law) by fallacious logic.

Again, there is a nexus with the UK accountancy profession in creating IAS 1, with its false logic. It is a matter of public record<sup>6</sup> that IAS 1 was drafted personally by Henry Benson, the founder of the International Accounting Standards Board (then head of Coopers & Lybrand, the predecessor firm to PwC and also former ICAEW President).

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<sup>1</sup> Para 9-14 of the Opinion

<sup>2</sup> Para 9 of the Opinion

<sup>3</sup> Para 26 of the Opinion

<sup>4</sup> Sir David Tweedie, Chairman of the IASB for the period when IFRS was adopted for the EU, is a member of ICAS.

<sup>5</sup> Para 11-11 of the Opinion

<sup>6</sup> Financial Reporting and Global Capital Markets. Kees Camfferman and Stephen A Zeff, Oxford, 2007

The fact that ICAEW Guidance from 1982 is wrong, and FRC guidance is similarly wrong by relying on it, raises a fundamental question as to why the FRC as regulator could ever think it was appropriate to rely on the position of the professional body it is supposed to regulate. There is an obvious conflict of interest here, as the European public interest is unlikely to be served by the legally defensive self-interest of the UK accounting profession. It has been the UK accounting profession, and banking industry, which popularised IFRS and led its export into Europe.

Given that the FRC position is not independent from the UK accounting profession and has been wrong for a number of years, LAPFF is very concerned about any ICAEW and FRC representation within the IFRS endorsement process.

In summary, the consequences of this are: IFRS requires that accounts are prepared by following IFRS, with the vague obligation that the information is 'useful'. That does not reach the standard of EU law which is requiring a true and fair view of the profits and net asset numbers as stated in the accounts, including for the purpose of enabling a lawful distribution of profits. The issues are far from trivial, as exemplified by the banks getting the standards wrong meaning that the accounts in some cases were catastrophically wrong.

LAPFF believes that members of the European Parliament should reject IFRS 9, and seek a full independent review of the legal processes of IFRS endorsement in terms to be set down by the Parliament itself.

We cannot think of another area of law where the regulated party is not only involved in setting and endorsing standards under the law, but has also been in control of the interpretation of the law under which the standards are set, which in this case is an incorrect representation of the law. By this route, the accounting profession has effectively become a 'state within a state', interpreting the law incorrectly to suit its own interests, and in LAPFF's opinion against the public interest.

In this matter the European Parliament has a vital role as a last line of defence to protect financial stability and the public good. We would be happy to produce further evidence at your request and urge the Parliament to review this evidence as soon as possible.

Yours sincerely



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**Enclosed:**

Opinion of George Bompas QC, 14<sup>th</sup> August 2015