Response to “Sharman Implementation” consultation paper
April 2013

Local Authority Pension Fund Forum

Sharman Implementation – Going concern

The Local Authority Pension Fund Forum was set up in 1991 and is a voluntary association of 56 local authority pension funds based in the UK with combined assets of approximately £115 billion. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

Response

The Sharman Enquiry – Going Concern

LAPFF welcomes the Sharman Review and its findings, hence this response is an overview of the treatment of going concern on the basis that the Panel had been asking precisely the right questions and coming up with the right answers.

LAPFF notes in particular that the Sharman Panel recognises that assessing going concern requires prudent accounting policies, and that this assessment is not consistent with IFRS in several material respects.

The rigour in addressing the fundamentals, which is the approach of the Sharman Review, is contrary to the approach of the parties that have been setting and endorsing accounting standards. In LAPFF’s opinion, these parties have been missing the fundamentals of prudent accounting and true and fair view altogether. It seems highly likely that this is associated with both the compliance and litigation avoidance culture of the US accounting profession.

LAPFF agrees that applying the “going concern” basis of accounting is a decision, which is itself dependent on a rational basis for assuming that a company is a going concern or not. To justify accounts being prepared on a going concern basis, it is necessary to account for those things that are prerequisites to being a going concern (such as reliable capital and reserves) or are in fact are barriers to a company being a going concern (such as likely losses and liabilities).

However, if one works on a compliance basis, based on criteria in accounting standards that do not address the fundamental issue of going concern, then it is not surprising that the accounts may portray a company to be in rude health when it is not in fact a going concern.

LAPFF wrote to Baroness Hogg in January 2013, drawing attention to the fact that the former chairman of the International Accounting Standards Board (IASB) (also the former chairman of the Accounting Standards Board) is on the record, from at least 1988, stating that he had discovered a “progressive” version of the true and fair view, that inter-alia excluded prudence and distributable profits[1].

LAPFF observes nothing in the statute, or subsequent UK and EU case law, that has validated that version of the true and far view. Distributable profits are essential elements of assessing going concern in the context of the maintenance of capital. Indeed LAPFF notes that two Parliamentary committees had considered the “progressive” model, and concluded on both occasions that it was inconsistent with being a going concern and not suitable as a basis for statutory accounts.

The concern about that incompatibility has now had a demonstrable outcome. There is a fundamental incompatibility being between the objectives of IFRS and a proper set of true and fair view accounts for banking companies and groups.

More generally, LAPFF believes that accounting standards have been set with:-

- a lack of attention to the law, or a deliberate avoidance of it[2]
- a lack of research on why the law was what it was
- a compliance culture, alongside auditors denying responsibility for this, although the attention to going concern would logically require it.

Essentially two approaches seem to have collided: risk mitigation on the one hand and academic adventuring on the other.

LAPFF notes a consistent appearance of “risk” partners in accounting standard setting, at Financial Reporting Council (FRC) and the European Financial Reporting Advisory Group (EFRAG) level. As their role is inevitably to reduce the litigation risk to their firms, there must always be the inherent risk that they are setting standards with ulterior motives, or setting standards without informing lay-members of all of the facts.

[1] “Making Corporate Reporting Valuable” – ICAS 1988

[2] See the rubric to FRS 18 (2000) paragraphs 18 and 19. The ASB had made proposals that it admitted were contrary to company law by not dealing with realised v. unrealised profits. The final standard recognises opposition on the basis that such opposition would have been unlawful and companies would be at risk of “flouting the law”.

