LEGAL OPINION OBTAINED BY ACCOUNTING STANDARDS COMMITTEE OF TRUE AND FAIR VIEW, WITH PARTICULAR REFERENCE TO THE ROLE OF ACCOUNTING STANDARDS

The Accounting Standards Committee Joint Opinion was updated by the Opinion above and provides useful background information.

1. The Accounting Standards Committee ("ASC") from time to time issues Statements of Standard Accounting Practice ("SSAPS"). These are declared in the Explanatory Foreword to be "methods of accounting approved...for application to all financial accounts intended to give a true and fair view of financial position and profit or loss." They are not intended to be "a comprehensive code of rigid rules" but departures from them should be disclosed and explained. The Committee also noted in its Explanatory Forewords that "methods of financial accounting evolve and alter in response to changing business and economic needs. From time to time new accounting standards will be drawn at progressive levels, and established standards will be reviewed with the object of improvement in the light of the new needs and developments."

2. The ASC has recently undertaken a review of the standard setting process and decided that future standards will "deal only with those matters which are of major and fundamental importance and affect the generality of companies" but that, as in the past, the standards will apply "to all accounts which are intended to show a true and fair view of financial position and profit or loss". A SSAP is therefore a declaration by the ASC, on behalf of its constituent professional bodies, that save in exceptional circumstances accounts which do not comply with the standard will not give a true and fair view.

3. But the preparation of accounts which give a true and fair view is not merely a matter of compliance with professional standards. In many important cases it is a requirement of law. Since 1947 all accounts prepared for the purpose of compliance with the Companies Acts have been required to "give a true and fair view": s.13(1) of the Companies Act 1947, re-enacted as s.149(1) of the Companies Act 1948. In 1978 the concept of a true and fair view was adopted by the EEC Council in its Fourth Directive "on the annual accounts of certain types of companies". The Directive combined the requirement of giving a true and fair view with extremely detailed provisions about the form and contents of the accounts but the obligation to give a true and fair view was declared to be overriding. Accounts must not comply with the detailed requirements if this would prevent would prevent them from giving a true and fair view. Parliament gave effect to the Directive by passing the Companies Act. This substitutes a new s.149(2) in the Act, reproducing the old s.149(1) in substantially similar words. The detailed requirements of the Directive appear as a new Eighth Schedule to the 1948 Act. The old s.149(1) (now renumbered s.149A(1) and the old Eighth Schedule (now Sch 8A) are retained for the accounts of banking, insurance and shipping companies. So far as the requirement to give a true and fair view is concerned, a difference between 149(2) and 149A(1) is that the former has come into the law via Brussels whereas the latter has no EEC pedigree.

4. "True and fair view" is thus a legal concept and the question of whether company accounts comply with s.149(2) (or s.149A(1)) can be authoritatively decided only by a court. This gives rise to a number of questions about the relationship between the legal requirement and the True and fair SSAPs issued by the ASC, which also claim

to be authoritative statements on what is a true and fair view. What happens if there is a conflict between the professional standards demanded by the ASC and the decisions of the courts on the requirements of the Companies Acts? Furthermore, the ASC issues new SSAPs "at progressive levels" and reviews established ones. How is this consistent with a statutory requirement of a true and fair view which has been embodied in the law in the same language since 1947? Can the issue of a new SSAP make it unlawful to prepare accounts in a form which would previously have been lawful? How can the ASC have power to legislate in this way?

5. To answer these questions it is necessary first to examine the nature of the "true and fair view" concept as used in the Companies Act. It is an abstraction or philosophical concept expressed in simple English. The law uses many similar concepts, of which "reasonable care" is perhaps the most familiar example. It is a common feature of such concepts that there is seldom any difficulty in understanding what they mean but frequent controversy over their application or particular facts. One reason for this phenomenon is that because such concepts represent a very high level of abstraction which has to be applied to an infinite variety of concrete facts, there can never be a sharply defined line between, for example, what is reasonable care and what is not. There will always be a penumbral area in which views may reasonably differ.

6. The courts have never attempted to define "true and fair" in the sense of offering a paraphrase in other languages and in our opinion have been wise not to do so. When a concept can be expressed in ordinary English words, we do not think that it illuminates their meaning to attempt to frame a definition. We doubt, for example, whether the man on the Clapham omnibus has really contributed very much to the understanding of reasonable care or that accountants have found it helpful to ask themselves how this imaginary passenger would have prepared a set of accounts. It is much more useful to illustrate the concept in action, for example, to explain why certain accounts do or do not give a true and fair view.

7. It is however important to observe that the application of the concept involves judgment in questions of degree. The information contained in accounts must be accurate and comprehensive (to mention two of the most obvious elements which contribute to a true and fair view) to within acceptable limits. What is acceptable and how is this to be achieved? Reasonable businessmen and accountants may differ over the degree of accuracy or comprehensiveness which in particular cases the accounts should attain. Equally, there may sometimes be room for differences over the method to adopt in order to give a true and fair view, cases in which there may be more than one "true and fair view" of the same financial position. Again, because "true and fair view" involves questions of degree, we think that cost-effectiveness must play a part in deciding the amount of information which is sufficient to make accounts true and fair.

8. In the end, as we have said, the question of whether accounts give a true and fair view in compliance with the Companies Acts must be decided by a judge. But the courts look for guidance on this question to the ordinary practices of professional accountants. This is not merely because accounts are expressed in a language which judges find difficult to understand. This may sometimes be true but it is a minor reason for the importance which the courts attach to evidence of accountancy practice. The important reason is inherent in the nature of the "true and fair" concept. Accounts will not be true and fair unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are

addressed. On this question, accountants can express an informed professional opinion on what, in current circumstances, it is thought that accounts should reasonably contain. But they can do more than that. The readership of accounts will consist of businessmen, investors, bankers and so forth, as well as professional accountants. But the expectations of the readers will have been moulded by the practices of accountants because by a large they will expect get what they ordinarily get and that in turn will depend upon the normal practices of accountants.

9. For these reasons, the courts will treat compliance with accepted accounting principles as prima facie evidence that the accounts are true and fair. Equally, deviation from accepted principles will be prima facie evidence that they are not. We have not been able to find reported cases on the specific question of whether accounts are true and fair, although the question has been adverted to in the course of judgements on other matters; see for example Willingale v International Commercial Bank Ltd [1978] A.C. 834. There are however some cases on the analogous question arising in income tax cases of whether profit or loss has been calculated in accordance with "the correct principles of commercial accountancy" and there is a helpful statement of principle (approved in subsequent cases in the Court of Appeal) by Pennycuik V-C in Odeon Associated Theatres Ltd v Jones (Inspector of Taxes) [1971] 1 W.L.R. 442 at 454:-

> "In order to ascertain what are the correct principles (the court) has recourse to the evidence of accountants. That evidence is conclusive on the practice of accountants in the sense of the principles on which accountants act in practice. That is a question of pure fact, but the court itself has to make a final decision as to whether that practice corresponds to the correct principles of commercial accountancy. No doubt in the vast proportion of cases the court will agree with the accountants but it will not necessarily do so. Again, there may be a divergency of views between the accountants, or there may be alternative principles, none of which can be said to be incorrect, or of course there may be no accountancy evidence at all...At the end of the day the court must determine what is the correct principle of commercial accountancy to be applied."

10. This is also in our opinion the relationship between generally accepted accounting principles and the legal concept of "true and fair". The function of the ASC is to formulate what it considers should be generally accepted accounting principles. Thus the value of a SSAP to a court which has to decide whether accounts are true and fair is two-fold. First, it represents an important statement of professional opinion about the standards which readers may reasonably expect in accounts which are intended to be true and fair. The SSAP is intended to crystallise professional opinion and reduce penumbral areas in which divergent practices exist and can each have a claim to being "true and fair". Secondly, because accountants are professionally obliged to comply with a SSAP, it creates in the readers an expectation that the accounts will be in conformity with the prescribed standards. This is in itself a reason why accounts which depart from the standard without adequate justification or explanation may be held not to be true and fair. The importance of expectations was emphasised by the Court of Appeal in what may be regarded as a converse case, Re Press Caps [1949] Ch.434. An ordinary historic cost balance sheet was said to be "true and fair" notwithstanding that it gave no information about the current value of freehold properties because, it was said, no one familiar with accounting conventions would expect it to include such information.

11. A SSAP therefore has no direct legal effect. It is simply a rule of professional conduct for accountants. But in our opinion it is likely to have an indirect effect on the content

which the courts will give to the "true and fair" concept. The effect of a SSAP may therefore be to make it likely that accounts which would previously have been considered true and fair will no longer satisfy the law. Perhaps the most dramatic example arises out of the recent statement by the ASC in connection with its review of SSAP 16 "Current Cost Accounting". The Statement puts forward for discussion the proposition that "where a company is materially affected by changing prices, pure HC accounts do not give a true and fair view". If this proposition were embodied in a new SSAP and accepted by the courts, the legal requirements of a true and fair view will have undergone a revolutionary change.

12. There is no inconsistency between such a change brought about by changing professional opinion and the rule that words in a statute much be construed in accordance with the meaning which they bore when the statute was passed. The meaning of true and fair remains what it was in 1947. It is the content given to the concept which has changed. This is something which constantly happens to such concepts. For example, the Bill of Rights 1688 prohibited "cruel and unusual punishments". There has been no change in the meaning of "cruel" since 1688. The definition in Dr Johnson's Dictionary of 1755 ("pleased with hurting others, inhuman, hard-hearted, without pity, barbarous") is much the same as in a modern dictionary. But changes in society mean that a judge in 1983 would unquestionably characterise punishments as "cruel" which his predecessor of 1688 would not have thought to come within this description. The meaning of the concept remains the same; the facts to which it is applied have changed.

13. The possibility of changing accounting standards has been recognised both by the courts and the legislature. In Associated Portland Cement Manufacturers Ltd v Price Commission [1975] I.C.R. 27, esp. at 45-6, the court recognised changes since 1945 in the permissible methods of calculating depreciation. Similarly para 90 of the new Eighth Schedule to the Companies Act 1948 refers to "principles generally accepted...at the time when those accounts are prepared".

14. We therefore see no conflict between the functions of the ASC in formulating standards which it declares to be essential to true and fair accounts and the functions of the courts in deciding whether the accounts satisfy the law. The courts are of course not bound by a SSAP. A court may say that accounts which ignore them are nevertheless true and fair. But the immediate effect of a SSAP is to strengthen the likelihood that a court will hold that compliance with the prescribed standard is necessary for the accounts to give a true and fair view. In the absence of a SSAP, a court is unlikely to reject accounts drawn up in accordance with principles which command some respectable professional support. The issue of a SSAP has the effect, for the two reasons which we have given in para 10, of creating a prima facie presumption that accounts which do not comply are not true and fair. This presumption is then strengthened or weakened by the extent to which the SSAP is actually accepted and applied. Universal acceptance means that it is highly unlikely that a court would accept accounts drawn up according to different principles. On the other hand, if there remains a strong body of professional opinion which consistently opts out of applying the SSAP, giving reasons which the ASC may consider inadequate, the prima facie presumption against such accounts is weakened.

15. We therefore do not think that the ASC should be concerned by the possibility that a court may hold that compliance with one of its SSAPs is not necessary for the purposes of the Companies Acts. This possibility is inherent in the fact that the courts

are not bound by professional opinion. The function of the ASC is to express their professional judgment on the standards which in their opinion are required.

16. There are two further points to be considered. The first is the relationship between the "true and fair" requirement and the detailed provisions of the new Eighth Schedule. The Act is quite explicit on this point: the true and fair view is overriding. Nevertheless it may be said that the detailed requirements offer some guidance as to the principles which Parliament considered would give a true and fair view. In particular, the Schedule plainly regards historic cost accounting as the norm and current cost accounting as an optional alternative. In these circumstances, is a court likely to follow a SSAP which declares that for certain companies, historic cost accounts cannot give a true and fair view? In our opinion, whatever reasons there may be for taking one view or the other, the provisions of the Eighth Schedule are no obstacle to accepting such a SSAP. As we have already pointed out, the provisions of the Schedule are static whereas the concept of a true and fair view is dynamic. If the latter is overriding, it is not impossible that the effect in time will be to render obsolete some of the provisions of the Schedule. But we think that this is what must have been intended when overriding force was given to a concept with a changing content.

17. Lastly, there is the effect of the adoption of "true and fair" by the EEC. Because s.149(2) of the 1948 Act now gives effect to a Directive, it must (unlike s.149A(1)) be construed in accordance with any decision of the European Court on the meaning of Article 2.3 of the Directive. In practice we do not think that this is likely to affect the evolution of the concept in England. Just as the concept may have a different content at different times, so it may have a different content in different countries. Although the European Court may seek to achieve some uniformity by laying down minimum standards for the accounts of all EEC countries, it seems to us that they are unlikely to disapprove of higher standards being required by the professional bodies of individual states and in consequence, higher legal criteria for what is a true and fair view being adopted in the national court of some member states.

18. So for example Article 33 of the Directive gives member states the right to "permit or require" companies to use current cost accounting instead of historic cost principles. In the UK, as we have said, current cost accounts are permitted by the Eighth Schedule but the only circumstances in which they may be required is if a court should decide, on the basis of prevailing principles, that they were necessary to give a true and fair view. In Germany on the other hand, the equivalent of the Eighth Schedule does not even permit current cost accounts. In Germany, therefore, the only way they could be permitted would be if the German court applied "true and fair view" as an overriding requirement. For the reasons given in para 16, we do not regard it as illogical or impossible that even a German court may take this view. But having regard to the Directive, we think it is very unlikely that the European Court would decide as a matter of community law that there are circumstances in which historic cost accounts do not give a true and fair view. Developments of this kind are more likely to be left to national courts to make in the light of local professional opinion.

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