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Governance *in brief*
FRC re-confirms the primacy of the 'True and fair' view

Headlines

- True & fair is a requirement of UK & EU law – IFRS does not change that.
- More detailed accounting standards do not remove the need for professional judgement.
- The concept of prudence continues to underlie the preparation of accounts under both IFRS and UK GAAP.

Why is the FRC issuing this now?

The FRC is responding to concerns on the operation of the true and fair override in IFRS and the absence of the term "prudence" following changes made by the IASB in 2010 during the first phase of its Conceptual Framework project. The FRC has received a legal opinion confirming that these changes do not affect the fundamental importance of the requirement for financial statements to give a true and fair view. In particular, whilst terminology has changed, the true and fair override requirement still exists in the same substantive form.

Why is this important for those charged with governance?

The FRC paper ('True and fair – June 2014') notes that whilst there has been a gradual shift over time to more detailed accounting standards, the preparation of financial statements cannot be reduced to a mechanistic compliance process; indeed, the FRC remind directors that the need to comply with detailed rules cannot excuse poor accounting. Objective professional judgement must be applied by those preparing financial statements to ensure that they give a true and fair view.

The paper sets out a number of examples where professional judgement should be applied. Those charged with governance should consider these carefully when reviewing financial statements and discussing key judgements with management, paying particular attention:

- where there is a choice of accounting policy;
- when accounting for items not specifically covered by accounting standards;
- when considering what is and is not material;
- when deciding whether it is necessary to give appropriate disclosures beyond those required by the standards; and
- to checking that significant information is not obscured.

At the end of their review, those charged with governance should always stand back and ask themselves whether the financial statements give a true and fair view overall.

The importance of prudence

In the first phase of its revisions to the IFRS Conceptual Framework in 2010, the IASB removed explicit references to prudence, explaining that they considered that its inclusion may have led to excessive prudence and the deliberate understatement of assets or overstatement of liabilities. However, as part of the second phase of its review of the Conceptual Framework, the IASB is now proposing to reintroduce an explicit reference to prudence though this is not expected to be finalised until 2015. In the meantime the FRC is making it very clear that, irrespective of whether it is specifically included in the Conceptual Framework, the concept of prudence continues to underlie the preparation of accounts under both UK GAAP and IFRS.

Use of the true and fair override

The FRC paper makes the point that "true and fair" is not something that is merely a separate add-on to accounting standards. Rather the whole essence of standards is to provide for recognition, measurement, presentation and disclosure for specific aspects of financial reporting in a way that reflects economic reality and hence that provides a true and fair view. However, where directors and auditors do not believe that following a particular accounting policy will give a true and fair view they are legally required to adopt a more appropriate policy, even if this requires a departure from the accounting standard.

Key points to remember

The FRC makes it clear that it expects preparers, those charged with governance and auditors:

- always to stand back and ensure that the accounts as a whole do give a true and fair view;

- to provide additional disclosures when compliance with an accounting standard is insufficient to present a true and fair view;

- to use the true and fair override where compliance with the standards does not result in the presentation of a true and fair view; and

- to ensure that the consideration they give to these matters is evident in their deliberations and documentation.

In addition the paper states that where a company departs from a standard in order to give a true and fair view and a proper explanation is given of the reason for the departure and its effects, the Financial Reporting Review Panel will be reluctant to substitute its own judgement for that of the company's board unless it is not satisfied that the board has acted reasonably.

It is hoped that this will help ensure that accounts in the UK continue to demonstrate the high quality that users have come to expect.

Deloitte view

- We support this clear statement from the FRC on the continued importance of the concept of true and fair.

- We recommend that those charged with governance specifically consider, and document, their debate around truth and fairness of the financial statements.

To access the FRC 'True and fair' paper
Go to www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/True-and-Fair-June-2014.pdf

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