Irreconcilable Legal and Accounting Views of ‘A True and Fair View’:
An Emerging Alternative from Australian Reforms

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Abstract

Despite the dispute over the meaning of ‘a true and fair view’ ever since it was formally introduced by the Companies Act 1948 (UK), the concept has not only continued to be integral to financial reporting regimes of many countries, but its application has expanded in recent times. In Australia, however, its status has been subordinated by accounting standards. By examining the interpretations of this concept of anti-formalist law by two royal commissions against the notion of value, this paper attempts to explicate a pragmatic meaning of this concept. Its replacement paved by Australian reforms, however, with an accounting concept of “not misleading” enunciated by two royal commissions should bypass the dispute over the meaning of the true and fair view concept and restore the diminishing credibility of mandatory financial statements and their audits. It also has the potential to transcend the discordant interpretations and national idiosyncrasies of the true and fair view concept and provide a meaningful direction for international harmonisation of financial reporting.

Introduction

The ‘true and fair view’ (TFV) concept whose origin can be traced back at least to the Joint Stock Companies Registration and Regulation Act of 1844 (UK), that required preparation of ‘full and fair’ balance sheets is still integral to corporate financial reporting regimes in the UK and many other English speaking countries of the world. It evolved as a device for curtailing the unscrupulous activities of corporate opportunists that impeded the efficient functioning of corporate capitalism - a modern western European phenomenon which originated in the sixteenth century and was exported to the rest of the world by political colonialism and economic empire-building. Since the issuance of the European Community’s Fourth Directive in July 1978, this concept has also been extended to the nations of the European Economic Community and more recently adopted by the Nordic countries as well. Notwithstanding the widespread application of this term, its interpretation has been the subject of dispute between accountants and lawyers ever since it was formally introduced by the Companies Act 1948 (UK) and the purpose served by it remains unclear.

In Australia, the TFV concept has been in the companies’ legislation since the Victorian Companies Act of 1890. Following the amendments to the Corporations Law 1989 emanating from the Corporate Law Economic Reform Program 1997-1998, however, its status has been subordinated by the Australian accounting standards. The Corporations Act 2001 (Cth) now makes compliance with accounting standards mandatory (s296) and the TFV requirement is to be satisfied through the notes, only if necessary (s297). In addition, the statutory provisions of the Corporations Act 2001 (Cth) (previously referred to as the Corporations Law) that supported the TFV requirement (old s294 and Schedule 5) have also been repealed. In view of the unresolved dispute over the meaning of this concept and subordination of the authority of the TFV concept as the overriding qualitative standard for financial reporting by the Australian accounting standards, this study attempts to answer two related questions. First, is the TFV concept as elusive as it is generally perceived to be? Second, does compliance with accounting standards satisfy the ‘true and fair view’ requirement?

The paper is organised in seven sections. The legal and accounting views of a TFV are considered in section one. The TFV as a concept of law is examined in section two. Rules of statutory interpretation and the notion of ‘value’ that is central to the accounting application of this concept are examined in sections three and four respectively. The search for a substance-over-form meaning of a TFV is conducted in the interpretations by two royal commissions in Australia in section five. Whether compliance with accounting standards results in a TFV and implications of the recent law reforms in Australia are considered in section six. Research findings and the rationale for replacing the TFV concept with an accounting concept are summarised in the seventh and concluding section.

Legal and Accounting Views of a True and Fair View

The legal view of a TFV that has traditionally favoured conservatism in financial reporting has probably been shaped by the late nineteenth and early twentieth century views of the courts on the function of audits and the purpose of a balance sheet. In Re London and General Bank (No.2), for example, the purpose of the statutory audit was described as securing “to shareholders independent and reliable information respecting the true financial position of the company at the time of the audit”. The conservative view of “true financial position” was enunciated in Newton v Birmingham Small Arms Ltd where the court described the purpose of the balance sheet as showing that the financial position of the company was at least as good as there stated, not showing that it was not or may not be better.

The accounting (also referred to as ‘professional’) view,
on the other hand, generally tends to be that compliance with accepted accounting principles (standards) is prima facie evidence that the accounts are true and fair. This view has generally been formed as a result of the semantics and form rather than on the substance of the TFV concept. Consequently, the TFV concept has been labelled, *inter alia*, as elusive, undefined, all-encompassing, anachronistic and unrealistic in terms of contemporary corporate markets. The accounting view has apparently been shaped by the pronouncements of the conceptual framework of accounting and accounting standards in countries such as the US, UK, Canada and Australia, which generally advocate departure from the principles of conservatism and prudence and permit innovation and optimism in financial reporting. The incompatibility of the conservative legal view with the increasingly liberal accounting view is apparently seen as "a formula for international disharmony".22

That the dispute is primarily over the notions of conservatism and prudence as virtues in financial reporting is evidenced by the view of the TFV as causing tension between "less prudent Anglo-American accounting practice" and the prudence principle of European continental accounting practice. In the struggle between the two opposing views, the accounting view seems to have attained ascendancy. As in Australia, for example, following the reforms introduced by the Companies Act 1989 (UK), the accounting view has acquired statutory backing in the UK as well. The divergence between the two views has apparently been perpetuated due to a failure or unwillingness on the part of accountants to understand the TFV as a concept of law and a failure or unwillingness on the part of lawyers to understand the complexities arising from its application to accounting.

**True and Fair View as a Concept of Law**

Law, in its structure - not just in specific substantive laws, is complex, multifaceted and contradictory. Although defining law is almost impossible, it may be perceived in at least four ways. First, law may be viewed like any other resource the value of which can be said to be dependent upon its scarcity. Accordingly, law may be regarded more precious when one realises the perils that might follow and are known to have followed its negation. Second, law has been described as "the reign of order … [and] a method whereby human beings may live together in organised co-operation …". Third, law has been described as the union of primary and secondary rules. Primary rules are said to be the rules of obligation - what one can do or must abstain from doing. Secondary rules are rules of recognition - rules that confer powers for operations, which lead to the creation and variation of duties and obligations and introduction of new rules of the primary type. Fourth, law has been perceived as models of law such as neutral and partisan (political) models.

Within the concept of law can be distinguished the ideology of law (as in the rule of law), legal ideology (ideas expressed in law), legal policy (the purpose of law), legal content (the actual wording of statutes and cases), legal forms and institutions, legal and quasi-legal professions, and legal techniques. These different elements, however, do not necessarily work in harmony - one can be used to counter another. Whether the law is specific or general, it is possible to achieve mere compliance (i.e. creative compliance), because legal techniques can be used to work within the content of statutes and cases to produce a method literally complying with the words of the law while none the less defeating its primary purpose.

A further contradiction in the law is that it is not neutral. Instead, it is a manifestation of "a constant and simultaneous demand for two opposing solutions, more precise rules to eliminate uncertainty about what is required and more general rules to eliminate ‘cook-book’ avoidance". The former may be referred to as formalism or legalism, and the latter as anti-formalism or substance over form. Formalism implies a narrow approach to legal control - such as by use of clearly defined and highly administrable rules with emphasis on uniformity, consistency, predictability, legal form and literal interpretation. At the heart of formalism, lies the concept of decision making according to ‘rule’ - implying that the language of a rule’s formulation - its literal mandate - be followed, even when this ill serves its purpose. Anti-formalism, on the other hand, is characterised by an approach which is more flexible, open-textured and policy oriented, with emphasis on the substance, purpose and ‘spirit’ of regulation, which call for dynamic responses. In view of these contradictions, the only thing that can reasonably be sought to be achieved in the law is a compromise between the two opposing demands. One outcome of seeking this compromise is a mixture of formalism and anti-formalism in the codified law such as the anti-formalist TFV and the supporting formalist legislation of the old Corporations Law - eg section 294 and Schedule 5 that have recently been repealed.

Both formalism and anti-formalism, however, are equally open to attack. As the rule (ideology) of law requires the citizens to be governed by the law and not by whim of the governors, the citizens can call for certainty, clarity and specificity on the grounds of fundamental rights under the rule of law. Viewed as a dominant theme in the legitimisation of the democratic state, this ideology of law provides a powerful tool for lobbying against the substance-over-form approach, and can be used to draw politically resonant limits on what can be done as law. Contemporaneously, however, the citizens can also argue with equal force that prescriptiveness of the law is the essence of the problem with legalism, which leads to a ‘cook-book’ approach to interpretation and acts as an obstacle to complying with the substance or ‘spirit’ of the law. On this ground, they can call for the removal of formalism in the law and their replacement with anti-formalism. In Australia both the anti-formalist TFV and the supporting formalist legislation that was apparently designed to assist in the interpretation of the TFV have been under attack. However, only the supporting formalist legislation has been repealed - thus retaining the TFV concept but only after dismembering its crucial formalist interpretative framework.

**Rules of Statutory Interpretation**

To facilitate the discovery of the meaning of complex, multifaceted and contradictory laws, the courts have evolved, over a long period, a number of approaches and presumptions. For convenience these are often referred to as ‘rules’, although there is a danger that by elevating them to the level of ‘rules’, it may give the impression that they are strictly applied by the courts, when in fact they can only be regarded as aids to interpretation.

The plain meaning rule, the *golden rule*, the mischief rule
and the purposive approach are four general rules of statutory interpretation.36 If the meaning of an Act is plain, the first rule requires it to be given that plain meaning.37 If the plain meaning rule is not of assistance, then the golden rule must be invoked, which requires that manifest absurdity and injustice be avoided. As there is a risk that this rule may be carried too far, it must be applied very sparingly - i.e. there must be ‘manifest absurdity’ or ‘patent absurdity’.38

Under the mischief rule contemporaneous circumstances and material such as the report of the royal commission that led to the enactment of a particular statute may be looked at to find the meaning of the words in the statute.39 The purpose of the mischief rule is not to ascertain the intention of the words used in the subsequent Act, but to determine the evil or defect which the Act of Parliament was intended to remedy.40

To find the Parliament’s intention in enacting a particular statute there is a growing tendency to adopt the purposive approach.41 Under this approach it is argued that the proper interpretation of an Act of Parliament is not a mere mechanical exercise. For this reason material such as international conventions, reports of committees of inquiries, royal commissions, law reform commissions, parliamentary debates preceding the enactment of the legislation and other material outside the Act may be looked at to find the purpose or the intention of the legislature.42

Concept of Value and True and Fair View

Since it is largely the reported values that determine whether or not the financial statements give a true and fair view, the concept of value cannot be separated from the TFV concept when applied to accounting. Two theories have been advanced in order to explain what makes value. First, the ‘labour theory’ of value, (effort) initially propounded by Adam Smith in The Wealth of Nations (published in 1776) claims that the basis of value is the labour used or cost incurred to make an object.43 “The value of any commodity, … to a person … is equal to the quantity of labour which it enables him/her to purchase or command. Labour, therefore, is the real measure of the exchangeable value of all commodities”.44 This theory, strongly asserted by Ricardo, has rallied round it economists of the most opposite schools - from optimists like Bastiat to socialists like Karl Marx, and has held a prominent place in the history of economic doctrine,45 although perhaps not well understood.

In his effort to explain the notion of labour and the political consequences for the development of labour, Karl Marx delved deeper into explaining the notion of ‘value’ which provides greater insight into the labour theory of value. The labour theory of value is attractive at least for two reasons. First, it appears to be scientific, in that it gives the foundation of value a precise, objective, quantitative notion, something that can be measured i.e. the amount of money paid for the labour used in the production of a commodity, although how objective measures for the differences in the nature of labour (eg physical or mental), and the degree of strenuousness of the tasks, can be obtained is not clear. Second, this theory of value satisfies the common sense notion of justice by making a moral element - labour - the basis of value, although this ‘moral’ motive might not be altogether convincing, because labour per se, if useless, cannot pretend to be of ‘moral’ value.46

This theory, however, is apparently simplistic and fails to explain at least four empirical phenomena relating to the notion of ‘value’. First, if the value of an object originates in, or consists in the labour devoted to its production, then that value ought to remain unchangeable. However, the empirical reality is that the values of most objects are continually varying.49 Second, if labour were the only cause of value, then for equal labour there should always be equal value, and vice versa.50 The empirical reality, however, is that objects which have cost the same amount of labour often sell at very different prices, and objects which cost very different amounts of labour often sell at very similar prices.51

Third, if labour were the only cause of value, then where there is no labour, there can be no value.52 However, there are innumerable things which have value of their own without any labour, simply because they are useful and sought after, such as minerals and unspoilt sandy beaches.53 Finally, with the advent of mechanisation, many objects are now produced by a combination of labour and technology, eg cars produced on an assembly line, or even by technology alone, such as electricity produced by generators. These undoubtedly are of value, but their relationship with labour would appear to be unclear and sometimes very remote. How these can be measured in terms of the ‘cost of labour’ only, therefore, becomes difficult to perceive.

For these reasons, the suggestion of the labour theory that value is solely a product of effort - irrespective of whether it is human labour or machine cost, is not totally defensible. To the contrary, it can be argued that “value does not lie in things at all; it comes from outside”.54 Value can, therefore, be thought of “as an illumination thrown on objects from the searchlight of our own desires” and as the ray changes direction, “it causes the objects of the outer world to start forth from the darkness, only to disappear again into the night so soon as it has passed over them”.55 So, the objects that have value at one moment, have none at another. What these empirical phenomena reveal is that whilst it cannot be said that there is no relationship between labour and value, it can be said that labour acts only indirectly on value. Labour can act by creating abundance or scarcity of an object, but as it is not the only cause of value, it cannot be used alone as a measure of value.

According to the second theory, the ‘final utility theory’, (degree of desirability), the value of an object is determined by the amount of satisfaction derived from the last unit of that object that is considered useful.56 The origin of this theory can again be traced back at least to Adam Smith’s The Wealth of Nations, although here he spoke only of ‘utility’ not ‘final utility’. “The word value, it is to be observed, has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods …”.57 (Emphasis added).

The final utility theory is said to be, in a way, the converse of the labour theory.58 Whereas the labour theory attaches itself to the effort made, the final utility theory attaches itself to the notion of satisfaction obtained.59 As Gide put it, this theory is based on a “very delicate and true psychological analysis of man’s [human’s] wants and their varying intensity”.60 For example, the utility of the first glass of water for a thirsty person would be very high, but this would diminish with each subsequent glass consumed and approaches zero for the last glass the person can drink. This psychophysiological analysis shows that as the number of units of any commodity increases,
not only the value of the commodity must gradually decrease, it is the utility of the last unit (least useful) which determines and limits the utility of all others. There is also an inseparable relationship between utility and scarcity. In the economic sense, utility varies with quantity - i.e. utility is a ‘function’ of quantity. However, in terms of the economic state, scarcity can be said to be merely a relative fact. For example, diamonds are rare, not only because nature has issued only a limited number of specimens, but because it requires a great deal of trouble or luck to find them.

So, which theory explains the concept of value better? Given the desire of the human mind to seek a single cause in everything, coupled with the apparent simplicity and moral appeal of the labour theory, and the intellectual impressiveness of the final utility theory, there is a great risk to be succumbed by one theory or the other. As Gide observed, each theory “represents only one side of the truth”. Value has two poles - utility and labour, pleasure and pain, which are not only different but also often contradictory. A person gets attached to things because of the pleasure (utility) he or she gets from the possession of them, or because of the trouble (labour) it has cost to obtain them. As a buyer and consumer, a person thinks of the pleasure the object will bring him or her, and as a seller he or she would think of the sacrifice in terms the trouble - cost incurred in obtaining it or the cost of replacing it. Again as Gide put it, while “these two feelings are simultaneously at work in an individual’s thoughts, value comes and goes between them like a shuttlecock between two battledores.”

If the notion of value is so complex, how can it be measured, which is central to accounting generally and financial reporting and a TFV in particular? If value can be perceived as the degree of desirability, then in order to measure value it is necessary to measure the intensity of the desire the object excites in the individuals who want to acquire it. Unfortunately, there is no device that can be used to obtain objective and reliable measure of the intensity of desires. As the value or wealth that an individual is prepared to give in exchange for some other object may represent an approximate measure of the intensity of the desire, exchange price or expected exchange price can be said to be the only fair proxies for the measure of value.

These proxies for the measurement of value also play a central role in the functioning of the capitalist economies. They create expectations, provide indications of the extent to which individual desires may be fulfilled and stimulate economic activity. Understatement of values may dampen expectations and lead to retardation in economic growth, whilst overstatement of values may result in creating unrealistic expectations that may eventually fail to be fulfilled due to lack of the commodities or other tangible properties which those values claim to represent. Further, if the principles of the market economy are to be upheld, then no single and simple valuation rule can be prescribed or use of multiple valuation methods proscribed. In a market economy, therefore, there can be no single measure of value that can be equated with the TFV concept.

True and Fair View as ‘Not Misleading’

Recognition of the complex and contradictory nature of law and equally complex concept of value and its role in a market economy are reflected in the interpretations of the TFV concept by the Royal Commission into the State Bank of South Australia (RCSBSA) and the Royal Commission into the Tricontinental Group of Companies (RCTGC).

Neither of the royal commissions defined the phrase ‘a true and fair view’. Instead, they preferred a functional (practical) as opposed to a nominal definition and a negative approach to interpret the concept of a TFV. Accordingly, they showed by exception the specific items of material misstatements and omissions that rendered the accounts ‘not true and fair’. In the RCSBSA, for example, the royal commission concurred with the interpretation of the auditor general who stated, “… as a result of matters arising out of the investigation, [he was] able to make a finding that the accounts did not give a TFV by reason of exceptions specifically noted”. The commissions also took guidance from common law and relied heavily on the supporting formalist legislation that the commissions considered was designed to assist in giving a TFV. Both commissions found that the accounts did not give ‘a true and fair view’ if they were ‘misleading’, thereby equating a TFV with ‘not misleading’.

Examples of material misstatements and omissions which in the Commission’s view rendered the accounts of the State Bank of South Australia and its subsidiary Beneficial Finance Corporation Ltd (BFC) misleading included the following:

(i) the adequacy of the specific and general provisions
(ii) the propriety of accepting the description of the $US150 million ‘perpetual debt capital’ as capital in accounts, thereby facilitating further lending by the Bank to the level of gearing permitted by Reserve Bank Prudential Guidelines
(iii) the overstatement of profits by crediting to the Superannuation Provision an asset revaluation surplus of $4.1 million
(iv) the understatement of Provision for Doubtful Debts of at least $22 million
(v) the wrongful attribution to Provision for Superannuation of cumulative Asset Revaluation surpluses of $9.2 million at the time, leading to a material overstatement of profit to that extent
(vi) the material overstatement of capital by inappropriate inclusion of subordinated perpetual debt as capital
(vii) significant understatement of Provision for Doubtful Debts in the accounts of the Bank and the Bank Group
(viii) misstatement of the Provision for Self Insurance
(ix) misstatement of the operating profit
(x) overstatement of BFC’s profits by inappropriate inclusion of $8.3million from sale of real estate development project which was an ‘abnormal item’
(xi) failure of the audit report to refer to the off-balance sheet entities, particularly as they had contributed by then $7.7million to BFC group losses

In light of these findings, the royal commission concurred

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Examples of material misstatements and omissions that in the commission's view rendered the accounts of the Tricontinental Group of Companies misleading included the following:

(i) Failure to make adequate provision for doubtful debts and reporting adjusted profits and related asset values in accordance with the "recognised accounting principles", which resulted in overstatement of reported profits and inflated asset values.\(^7\)

(ii) Inclusion of $98.9 million income tax benefit in the reported loss of $275.2 million in 1989, without which the reported loss would have been $374.1 million. This was done despite the fact that under an agreement between the Commonwealth and the Victorian Governments, Tricontinental was precluded from claiming $1,136 million of its bad debts as a tax deduction.\(^8\)

(iii) In December 1991, Tricontinental reported a further loss of $0.3 million. But for State Government reimbursement of expenses of $150.7 million, the loss in 1991 would have been $150.7 million.

(iv) For the 1990 financial year Tricontinental reported a profit of $148.8 million. But if the Government support in terms of acquisition of indebtedness or interest etc. pursuant to an agreement was absent, Tricontinental would have reported a loss of $1,719.3 million, which would have wiped out the entire capital base of State Bank of Victoria (SBV).\(^9\)

Both royal commissions showed that the accounts were not true and fair if they were misleading by reason of material misstatements and omissions that generally resulted in material overstatement of assets, equities and liabilities as required by the "recognised accounting principles", which resulted in overstatement of reported profits and inflated asset values.\(^7\)

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The misstatements and omissions that rendered the accounts of the State Bank of South Australia and the Tricontinental Group have invariably been found in financial reporting practices of many failed organizations across the globe, again witnessed in the recent collapse of HIH Insurance, Harris Scarfe and One.Tel.\(^7\) What the royal commission into HIH Insurance announced by the Prime Minister\(^8\) is likely to find in the accounts might therefore be said to be a foregone conclusion.

Law Reform, Accounting Standards and True and Fair View

Both royal commissions interpreted the anti-formalist concept of a TFV in tandem with the accounting principles contained in the supporting formalist law and the use of exchange price or expected exchange price as a basis for measurement of values. As a result of the Corporate Law Economic Reform Program of 1997-1998, however, this law as well as other supporting legislations have been repealed and their provisions incorporated in the accounting standards. Whether compliance with accounting standards was synonymous with compliance with the accounting principles of the repealed law and resulted in a TFV were considered to varying degrees in both royal commission inquiries.

In the case of the State Bank of South Australia, the auditors (KPMG Peat Marwick) of the Bank’s subsidiary, Beneficial Finance Corporation Ltd, submitted that in arriving at his conclusions the auditor general erred in his consideration of the relevant accounting standards.\(^7\) The royal commission, however, did not enter into a debate on the propriety or otherwise of accounting standards.

The question of ‘accounting principles’, which might be seen as synonymous with ‘accounting standards’ was, however, considered in the Tricontinental case. It was found here that the accounts did not give a TFV because they did not comply with “recognised accounting principles”. Referring to the accounting practice where provisions for losses were not included in the total loss for the year, the royal commission observed, “...it [was] entirely appropriate, and indeed required by recognised accounting principles designed to provide true and fair financial statements... that provisions for losses should be included in the total loss for a particular year, and in an evaluation of Tricontinental’s financial position at a later point in time. Not to do so would render the financial statements misleading”.\(^8\) The commission further noted that where the eventual repayment of those loans was doubtful, showing the loans in the balance sheet at their full face value would not provide a TFV.

The “recognised accounting principles” that the commission referred to were in section 294 of the Corporations Law 1989 and related regulations which have subsequently been repealed. Section 294(1) required compliance with all parts of that section before a company’s accounts were made under s292 that required a profit and loss account and s293 that required a balance sheet that gave a TFV of the performance and financial position respectively. Section 294(2) required directors to:

(a) find out what has been done about writing off bad debts and making provision for doubtful debts, and

(b) to cause all known bad debts to be written off and adequate provision to be made for doubtful debts.

Section 294(3) stipulated net realisable value and s294(4) replacement cost as the recognised accounting principles for valuation of current assets and non-current assets of going concerns respectively. As both Tricontinental Group and the State Bank of South Australia were in liquidation, the royal commissions considered estimated realisable values or “likely realisable values” as the appropriate principle for valuing both current and non-current assets, as required by the Corporations Regulations (Schedule 2 Form 507). For
measuring performance, both comparing net assets at two points in time and preparing a profit and loss account using the transactions method were considered equally acceptable. In the Tricontinental’s case the royal commission demonstrated that the two methods would give the same result, provided the principles applied in valuing assets were the same for each method.

If the question of whether the accounts had complied with accounting standards was debated, as the auditors of the State Bank of South Australia apparently wanted, it would probably have been difficult to establish if any accounting standards were breached. For some of the accounting practices that led to the material misstatements and omissions identified by the two royal commissions there are no accounting standards. For others the standards are generally diffusive and allow choice of multiple accounting practices. For example, there is no accounting standard that compels directors to write off bad debts and make adequate provision for doubtful debts which were the major causes for misleading financial statements in both cases. For the inappropriate classification of debt as capital that resulted in overstatement of the capital of the State Bank of South Australia, there is no accounting standard either. There are, however, accounting standards that deal with inventories and non-current assets. One accounting standard, AASB1019 Inventories, requires inventories to be measured at the lower of cost and net realisable value (para. 5.1), but does not prescribe any rules for the valuation of other current assets.

The practice of treating asset revaluation surpluses as revenue that resulted in overstatement of profits of the State Bank of South Australia was generally not permitted by AASB1010 Accounting for the Revaluation of Non-Current Assets (issued in 1989) in force at the time. However, the standard did allow this practice to the extent that the revaluation increment reversed a revaluation decrement previously recognised as an expense in the profit and loss account. These provisions are still in its successor standard AASB1041 (para. 6.2) issued in 1999. Further, whether cumulative revaluation decrements over a number of years can be recognised as revenue, referred to by the royal commission as ‘cumulative revaluation surpluses’, in a later year is not clear from the standards.

The old AASB1010 also required carrying amounts of non-current assets not to exceed their recoverable amounts (para. 3.1(c)). It defined recoverable amount as the net amount expected to be recovered through cash inflows and outflows arising from an asset’s continued use and its subsequent disposal (para. 12.1). The methods for differentiating and allocating cash inflows and outflows to various non-current assets and how, if at all, they were to be discounted were not explained. As the recoverable amount of an asset was virtually impossible to determine objectively, the standard permitted use of valuation bases that were not necessarily consistent with the legitimate bases of measurement of values in a capitalist economy.

In 1999, this standard was split into two - AASB1010 Recoverable Amount of Non-Current Assets and AASB1041 Revaluation of Non-Current Assets. The new AASB1010 is now concerned with the application of the recoverable amount test only (para. 4.1) and AASB1041 requires the use of either the cost basis or fair value basis for revaluation of non-current assets (para. 5.1). While cost represents actual exchange price, fair value which has been defined as the “amount for which an asset could be exchanged …” (AASB1041, para. 11.1), represents the expected exchange price. In light of the notion, measurement and role of value in a capitalist economy, this change in the standard can be seen as an implicit recognition of actual exchange price and expected exchange price as the only fair proxies for the measurement of value, which may have the potential to reduce reporting of misleading valuations in financial statements.

Changes to some accounting standards, however, have relaxed the practices that were found by the royal commissions to have rendered the accounts misleading. Inclusion of income tax benefit of loss that was another item that rendered the accounts of the Tricontinental Group misleading is permitted by AASB1020 Income Taxes. The 1996 issue of this standard (para. X) permitted recognition of tax benefit of loss as income only if the realisation of the benefit was “virtually certain”. The 1999 issue of the same standard (para. 4.4) has, however, relaxed the recognition criterion and allows tax benefit of loss to be recognised as long as “it is probable that the future taxable amounts within the entity will be available against which the unused tax loss can be utilised”.

Also, recognition of government grants and acquisition of indebtedness by government as revenue which were found in the case of the Tricontinental Group to be misleading, are permitted by AASB29 Financial Reporting by Government Departments ( paras. 10.3.2-10.3.3) and AASB1004 Revenue Departments (para. 10.1). These standards allow government “grants” and “assumption or forgiveness of liabilities by government” or by a creditor to be recognised as revenue. But grants are of capital nature and treating them as revenue violates a fundamental accounting principle of distinguishing capital from revenue. Likewise, a default on debt repayment might be an ominous sign of an impending insolvency, and permitting unpaid debts to be treated as revenue may not only conceal the actual financial affairs of a company but it may also contribute to a breach of insolvent trading legislation.

Further, an abnormal item that resulted in overstatement of profits in the case of State Bank of South Australia is a subject of AASB1018 Profit and Loss Accounts. The 1989 issue of this standard required separate disclosure of abnormal items, and disclosure of operating profits both before and after normal items. The 1999 issue of the same standard, however, has dropped the abnormal items classification altogether and has no requirement for abnormal items to be distinguished from normal operating profits. This standard thus legitimises a practice that has been found to result in misleading financial statements.

Some standards have thus changed to reduce the potential for misleading financial reporting while others have changed to increase it. Compliance with the existing accounting standards therefore does not provide any guarantee that financial statements will not be misleading and will give a TFV as interpreted by the two royal commissions. However, despite the potential for misleading financial statements, the accounting methods prescribed by these and other similar accounting standards cannot be proscribed. The nature of value is such that it will always be perceived, measured and reported in numerous ways - all of which can arguably be legitimate.
This brief analysis provides two important insights. First, it is a testimony to the failure of the much acclaimed and legally backed Conceptual Framework of Accounting (CFA), the proclaimed objective of which is to act as a constitution for the development of consistent accounting standards, that prescribe universally acceptable methods of valuation - an objective which is virtually impossible to achieve. Second, it reveals a conspicuous absence of an overriding guiding principle for the development of a defensible accounting regulatory regime. Hence, the existing regulatory regime is like a structure of bricks without mortar, built on a shifting ground, unable to withstand the inevitable shocks of the free market economy. This situation has apparently arisen from the perceived elusive nature and unenforceability of the TFV concept as the overriding qualitative standard and exacerbated by the effective abrogation of its statutory authority following the recent reforms.

Conclusion

The two royal commissions interpreted the anti-formalist TFV concept in tandem with the supporting formalist legislation as ‘not misleading by reason of material misstatements or omissions’. Following the amendments to the Corporations Law that emanated from the Corporate Law Economic Reform Program 1997-1998, the formalist legislation has been repealed, leaving the anti-formalist TFV without the supporting formalist legislation. Accounting standards have now replaced the repealed law although they are found to be a poor substitute. The history of unenforceability of the TFV concept, its outright rejection by accountants and the magnitude of the recent legislative reforms that have effectively abrogated its statutory authority, suggest that any hope of reinstating the TFV concept to its traditional status in Australia is neither realistic nor desirable.

The moral appeal and the ordinary meaning of the TFV concept present a risk not only of creating a false sense of confidence in the market, they also present a real risk of the concept being used as a moral cloak to cover immoral actions of corporate opportunists - the very outcomes that the TFV concept initially evolved to counteract. The reforms, whether by accident or by design, however, have paved the way to replace the legal concept of TFV that has been problematic to accountants and auditors with an accounting concept of “not misleading” - the meaning assigned to the TFV concept by the two royal commissions.

It could be argued that like the TFV concept, “not misleading” might also be equally elusive and mean different things to different people. However, as this meaning is encapsulated by the accounting concepts of materiality, misstatement and omission adopted in the accounting standard AASB1031 Materiality (paras. 4.1 and 5.1), the concept already belongs to the language of accounting and serves as a useful starting point for its refinement. The standard acknowledges that information is material if its omission, misstatement or non-disclosure has the potential to adversely affect decisions about resource allocations and discharge of accountability (para. 4.1). Some rules for determining what constitutes material are also provided by this standard.

Further, as examples of accounting practices that result in misleading financial statements are not difficult to find, it should not be difficult for accountants to determine what constitute material misstatements and omissions. The ensuing auditors’ attestation that the financial statements are “not misleading by reason of material misstatements or omissions” would be more meaningful than the statement that they give “a true and fair view”. Section 999 of the Corporations Act 2001 (Cth) already prohibits persons from making a statement, or disseminating information that is false in a material particular or materially misleading in relation to securities. This provision can easily be extended to include mandatory financial reporting and auditing which would make the concept legally enforceable.

The findings of the two royal commissions provide an authoritative basis for remedying some of the defects in the existing financial reporting provisions of the Corporations Act 2001 (Cth). A new overriding requirement that ‘the financial statements are not misleading by reason of material misstatements or omissions’ can form the basis for developing a series of consistent accounting and auditing standards and help restore the diminishing credibility of mandatory financial statements and their audits. This will also reaffirm the law reform role of royal commissions which are increasingly being perceived as mere instruments of politics and even been described as “a right royal waste of time”. Unlike cultural connotations of a TFV that have led to discordant interpretations, the concept of “not misleading” has the potential to transcend national idiosyncracies and assist in the development of consistent accounting standards for both national and international application and provide a meaningful direction to international harmonisation of financial reporting.
Endnotes

1. Lecturer, School of business University of Ballarat and text. The author is willing to share the data in this paper. This paper was presented at the Critical Perspectives on Accounting Conference, 25-27 April 2002, City University of New York and the author is grateful for the comments of the reviewers and participants of that conference.


10. Re London and General Bank (No.2) ([1895] 2 Ch 673 at 682 per Lindley, LJ.


21. ibid.

22. ibid.


24. ibid.


27. ibid.

28. ibid.


30. ibid, pp 80-81.

31. ibid, p 81

32. ibid, p 83


35. ibid.

Warburton v Loveland (1831) 2 D & Cl 480; Richardson v Austin (1911) 12 CLR 463; D.J. Gifford and K.H. Gifford, op cit, pp 92-93.

Holmes v Bradfield Rural District Council (1949) 2 KB 1, 7

Associated Newspapers Group Ltd v Fleming (1973) AC 628, 646; D.J. Gifford and K.H. Gifford, op cit, pp 92-93.


D.J. Gifford and K.H. Gifford, op cit, p 99.


D.J. Gifford and K.H. Gifford, op cit, p 104.

ibid; A.I. MacAdam and T.M. Smith, Statutes (Butterworths, Sydney, 1989), pp 278-279.


A. Smith, op cit, p 13.

C. Gide, op cit, p 49.

ibid, p 50.

ibid.

ibid.

ibid, pp 49-52.

ibid, p 52.

ibid.

ibid.

ibid.

ibid.

ibid, 53-56.

A. Smith, op cit, p 12.

C. Gide, op cit, p 53.

ibid.

ibid, p 55.

ibid.

ibid, pp 55-56.

ibid, p 56.

ibid.

ibid, p 57.

ibid.

ibid, pp 44-47.


ibid, pp 218-219.

ibid, pp 219-226.

RCTC, op cit, p 42.

ibid, p 45.

ibid.

ibid, p 72.


RCTGS, op cit, p 217.

RCTGC, op cit, p 42.

ibid.

ibid.

Corporations Act 2001 (Cth), s95A, s922(1).

Corporations Act 2001 (Cth), s588G.

Australian Securities and Investments Commission Act 1989 (Cth), s227(1).


