THE SUBTLE ART OF REDEFINING TRUTH

IF IT'S IN THE RULEBOOK, IT MUST BE RIGHT

By MARY M. GREENWELL

Amendments to the Corporations Law appear to encourage companies to place compliance with accounting standards above the "fairness" of their financial statements.

The recent tabling of amendments to the Corporation Law has sparked renewed interest in the ethical connotations of the phrase "a true and fair view". The effect of the amendments will be to change the order of priority between the ideal expressed in the phrase and the requirement to comply with approved applicable accounting standards.

In other words, financial accounts are to be prepared in accordance with approved applicable accounting standards even when that compliance will *not* give a true and fair view. The accounts are then to be corrected in the notes.

Is this not giving effect to the maxim "form over substance"? The effective downgrading of the true-and-fair requirement appears to result from a bizarre blurring of the distinction between bureaucracy and public benefit.

The phrase "true and fair", or a similar one, features in the companies legislation of several countries and is known to have been used as far back as the UK Joint Stock Companies Act of 1844. However, some historians put its origins in much older legal documents where it reflected the need to maintain an orderly conduct of business, a re-affirmation of mutual trust and goodwill between parties to a transaction.

Many papers have been written exploring finer meanings of the phrase. Some have focused on the literal meaning of the words "true" and "fair".

Various attributes of "truth" have been singled out — for example, *correspondence*; that is, do the numbers in the financial accounts correspond with the facts of financial transactions or events? Alternatively, truth can be seen as *logical correspondence*; that is, is there a logical relationship between various elements in the financial accounts?

Similarly, what is "fair"? One does not get very far with this question before coming up against the counter-question: fair to whom? Fair to the providers of debt or equity capital, or fair to the providers of blue or white-collar labour, or fair to society as a whole?

As a variety of writers were exploring these dimensions, the professional accounting bodies, primarily the Institute of Chartered Accountants in Australia (ICA) and the Australian Society of Certified Practising Accountants (ACSPA), were seemingly united in advancing a somewhat different meaning.

These bodies have stuck rigidly to the opinion that "true and fair" has a technical meaning unrelated to its literal meaning.

This technical meaning was seen to be linked to the conventions of accounting and embodied in the accounting standards. Hence, the "official" opinion was that the legal requirement to give a true and fair view would be satisfied by the prepa-

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ration of accounts in accordance with accounting standards.

This opinion has been challenged inside and outside courts of law. So far, there is no unequivocal legal precedent. At times, judges have held that the consistent application of accounting principles was sufficient to comply with the true-and-fair view requirement. At other times, differing judgments have held that correspondence with the underlying facts was necessary to conclude that a true and fair view was presented.

There is no doubt that the phrase is ambiguous and problematic. What is perhaps not so well accepted is that all accounting is ambiguous and problematic. Any set of financial accounts is limited by a variety of pre-determined "recognition" rules. For example, the relatively higher health-care costs of a community adjacent to a steelworks are not taken to account or recognised as an expense of steelmaking.

Financial accounting is also limited by judgments about the allocation of costs and revenues between periods, and, quite probably, by disagreements between directors and auditors which are settled by negotiation.

Accountants have been peculiarly remiss in educating the public about the contestability of financial statements. For example, the myth of freedom from bias in financial accounts is perpetuated in the conceptual framework project.

It is perhaps in response to this ambiguity that at last the Australian Accounting Research Foundation (AARF), the research arm funded by both ACSPA and ICA, has been able to influence sufficiently the actions of the Attorney-General. The amendments to the Corporations Law which downgrade the true-and-fair view requirement can be seen as the result of this influence. It has been argued, not only by AARF spokesmen but by various Big-6 partners, that some of the current financial scandals would not have occurred if accounting standards had been complied with.

At the same time, it has been argued — also by Big-6 partners as well as academics and financial journalists — that compliance with accounting standards would have made no difference, either because of diversity of options within standards, because of loose drafting of standards or because of the lack of a standard on a particular issue. Was non-compliance with accounting standards the problem the amendments were supposed to correct?

The solution, therefore, was to downgrade the true-and-fair view requirement and upgrade the requirement to comply with approved applicable accounting standards. But, in doing this, has the baby been thrown out with the bathwater?

True and fair: an ethical ideal?

An alternative is to look again at a true-and-fair view as an ethical ideal. In doing so, there arises an inference that some auditors may have neglected the ethical component of their claim to professionalism. This is not, however, an exercise in auditor-bashing. It is, rather, a recognition that sometimes auditors, too, were swept along in the euphoria that blinkered the investing public during the hey-day of the corporate cowboys. That past cannot be undone but perhaps lessons can be learned and applied to future judgments.

Is it not possible to recognise the problematic in the phrase "a true and fair view" and at the same time to regard it as an ethical ideal? Is it not time for auditors, as well as preparers of financial accounts with a claim to professionalism, to reaffirm their ethics? Ethics, rather than compliance with accounting standards, should be seen as the guide to good accounting practice.

What are ethics and ethical behaviour in accounting? The guidelines governing the conduct of members of both major professional accounting bodies may help — but proclaiming the letter of the guidelines without an appreciation of the underlying relevance of professional ethics is merely another example of elevating "form over substance". What is the role of education with respect to ethics? Is it merely to teach the content of the ethical guidelines? Professional examinations in ethics are restricted to examining such teaching. To what extent does this institutionalise the lack of importance of ethics?

Some have argued that the claim of auditors' independence is nonsense, given that companies both appoint and pay the auditors. Certainly, threatening to sack the auditor has at times resulted in the perpetuation of misleading financial reporting. Keeping the client happy and having the fees paid have undoubtedly led some auditors in the direction of unethical behaviour. On the other hand, some accountancy partners have publicly confirmed that they have used the overriding true-and-fair-view requirement to quell the excesses of some directors.

It has been argued that external auditing should be publicly funded but, given the current trend towards privatisation, this is an unlikely solution. What can be done to promote a return to the ethical track?

A return to ethics?

One suggestion is that financial reports should include a note which specifically identifies contentious issues, as well as the effect on the financial statements of the final decision made. This would at least provide users of the reports with some understanding of the range of figures possible. In turn, this would emphasise the very contestable nature of the reports.

The forthcoming requirement for auditing committees may also provide some means of illuminating the complexities of financial statements. For example, the issues considered by the committee may be included in the annual financial report. Information about such issues as the extent of audit funding may well encourage useful comparisons.

One implication inherent in these suggestions is that annual financial reports are indeed useful for providing any information and are read. Not everyone agrees that this is so. Some argue that financial reports should be simplified so as to be readily interpreted by a person in the street. But how many professional groups find it imperative to make their work intelligible to the untrained reader? In the case of financial accounts, is any good purpose served by the simplification of a complex set of figures that summarise possibly millions of diverse economic transactions and events? Perhaps the view which favours simplified accounts is linked to a reluctance to accept responsibility for a service ideal, the cornerstone of any claim to professionalism.

Truth, fairness and ethics: they are difficult to separate, but not difficult to debate. Such a debate might contribute to the coming-of-age of financial reporting. □