THE ACCOUNTING CONCEPT OF "*TRUE AND FAIR*"

by

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1. Introduction

Accounting, as a scientific process, is about provision of financial information required by owners, managers and other stakeholders to assess the health of the organization, ascertain the changes in the stock of the wealth of shareholders such that they are able to decide whether to retain their holdings, recommit more funds or divest entirely from the organisation. Beyond this historical function, accounting information also affords the numerous stakeholders the opportunity to assess the virility and viability of the enterprise and stewardship of managers. The type and form in which the stewardship reports should be presented are clearly spelt out in Section 334(2) of CAMD 1990.

2. Generally Accepted Accounting Principles(GAAP)

Financial accounting information are statutorily required to be prepared in line with the profession's universally accepted assumptions, principles and conventions which aid intra-firm, inter-firm and industry comparisons over time. This requirement ensures that the financial information gathered are objective, properly

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analyzed, interpreted and accurately transmitted to stakeholders, thus, making the financial statements reliable, precise and subject to objective review irrespective of the environment. These principles and conventions are complemented by standards, which are authoritative statements expressly issued by appropriate regulatory bodies, on how particular types of transactions and other events should be treated and reflected in financial statements in order to ensure that such reports are prepared in a uniformly accepted format. Although these principles and standards have universal application, they are usually adapted to suit local circumstances by the relevant national regulatory body because of the differences in national ethos and norms.

To ease the problems of understanding and application of these principles, conventions and standards and as well as ensure the credibility of financial statements, chartered accountants generally provide complete disclosures of all information about the transactions of a company and the accounting policies or principles, conventions, rules and procedures used in the preparation of the financial reports. In fact, the disclosure of the accounting policies used is an integral part and a statutory requirement of financial statements.

3. Attestation Function

The dynamics of business environment and the inadequacies of family resources, skills and expertise, made it imperative for ownership of many corporate entities to be separated from control if

resources were not to suffer undue diminution. Such separation and dilution of ownership necessitated the evolvement of checks and balances that will not only protect the wealth of investors who are not normally in a position to verify the quality of the information personally but also ensure that corporate goals are consistently pursued by the professional managers. Thus it became mandatory for shareholders to appoint and fix the fees of external auditors at Annual General Meetings to examine the reliability of the financial reports submitted to them by the board of directors.

The Committee on ***the Financial Aspects of Corporate Governance*** set up in U.K. succinctly stated in its 1992 report that "the audit provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balance required." Although external auditors are required to liaise with the management and the directors in order to effectively discharge their statutory duties, they are primarily responsible to the shareholders.Indeed, Section 359(1) of CAMA 1990 provides expressly that ***the auditors of a company shall make a report to its members*** (***shareholders***) ***on the accounts examined by them, and on every balance sheet and profit and loss account, and on all group financial statements copies of which are to be laid before the company in a general meeting during the auditors' tenure of office.***

Section 360(1) goes further to provide that ***it shall be the duty of the company's auditors, in preparing their report to carry out such investigations as may enable them form an opinion as to the following matters whether:***

< ***proper accounting records have been kept by the company and proper returns adequate for their audit have been received from branches not visited by them;***

< ***the company's balance sheet and (if not consolidated) its profits and loss account are in agreement with the accounting records and returns.***

Thus the attestation function involves ***the expression of an opinion*** on the financial statements prepared by directors and presented to shareholders as part of their fiduciary responsibilities.

4. The Nature of Audit Opinion

As it must be appreciated, opinions can only be expressed after the chartered accountant has conducted a detailed examination of the financial books kept by the company and confirms that they complied (or did not comply) with the generally accepted accounting principles. Indeed, such an opinion is intended to show the correspondence of the information to the economic activity it purports to describe and the objectivity exercised by management when processing it. In the view of Lee (1976) "the major objective is to ensure that shareholders are presented with credible information which they can use with a reasonable assurance that it has been prepared honestly and with due care." In other words, the statutory audit function enables the

auditor to ascertain whether the financial statements were prepared, in all material respects, in accordance with ***an identified financial reporting framework.*** Such a financial reporting framework selected by the Board of Directors usually embodies the concepts of going concern, historical cost, relevance, reliability, materiality and understandability, which are part of GAAP. It is important to emphasize that the financial reporting framework adopted by any organization is neither chosen nor drawn up by the external auditor whose duty is that of attestation. The board of directors exercises its discretion and professional wisdom in the choice of the financial reporting framework. The attestation role of the auditor is only to ensure full disclosures, consistent compliance to these principles and conventions and the **expression of an opinion** on the objectivity of these financial reports prepared by the directors.

In order to be able to arrive at a credible opinion Section 360(3) of CAMA 1990 provides that every auditor of a company shall have a right of access at all time to the company's books, accounts and vouchers, and be entitled to require from the company's office such information and explanations as he thinks necessary for the performance of his duties. Financial statements presented to shareholders without the auditor's verification in line with these auditing processes and statutory requirements would lack credibility. Auditing therefore gives financial statements the desired credibility. It is the integrity of the professional accountant expressed during his attestation function that encourages its numerous publics to rely on

the financial statements prepared by the board. Therefore, because of credibility, the attestation role has assumed greater importance in public and private discussions.

5. *The Concept of "True and Fair View"*

The phrase used to express the auditor's opinion is ***give "a true and fair view or present fairly"***, in all material respects. **But what does this expression mean to the layman in accounting?** This concept was first introduced[2] by the British Companies Act 1947 as an amendment to the hitherto existing requirement that auditors should examine financial statements with a view to ensuring that they were ***true and correct***. According to accounting research experts[3], the change was considered necessary on the grounds that there was no clear distinction between these two adjectives when used to describe financial statements. The riddle then was whether it was possible for financial statements to be "true" yet "incorrect" or "untrue" yet "correct". Thus, the ***true and fair*** concept was subsequently adopted by the European Community Council in its Fourth Directive which became operative in UK through the enactment of the revised Companies Acts in 1981 and 1985.

In a ***Foreword*** to Accounting Standards it issued in 1993, the UK Accounting Standards Board explains the relationship between compliance with the accounting standards and the concept of true

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[2] A large proportion of this section was extracted from UK GAAP(see next footnote).

and fair in these words: ***"Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements and accordingly compliance with accounting standards will normally be necessary for financial statement to give a true and fair view."*** It went on to add that "because accounting standards are formulated with the objective of ensuring that the information resulting from their application faithfully represents the underlying commercial activity, the Accounting Standards Board envisages that only in exceptional circumstances will departure from the requirements of an accounting standard be necessary in order for financial statements to give a true and fair view.

6. Legal Interpretations

Determined to ascertain the precise meaning of the true and fair requirement, including the legal relationship between accounting standards and the U.K Companies Act, the Accounting Standards Committee (ASC) in 1983 and 1984 sought the Joint Opinions of Leonard Hoffmann QC (now the Rt. Hon. Lord Justice Hoffmann) and Miss Mary Arden (now The Hon. Mrs. Justice Arden). They asserted authoritatively in 1983 that "***the courts would 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…."*** On the strength of this, it was concluded that the function of the ASC was

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[3] Davies, M., Paterson, R. & Wilson, A. (1997),"Generally Accepted Accounting Practice in the United Kingdom". Ernst and Young. Macmillan. 5th Edition.

to formulate what it considered to be the generally accepted accounting principles.

From this pronouncement, it was inferred that, the value of a Statement of Standard Accounting Principle (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. 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 the reason why accounts which depart from the standard without adequate justification or explanation may be held not to be true and fair. This view is supported in the judgement given by Woolf, J. in ***Lloyd Cheyham & Co Ltd v Littlejohn & Co,*** in which he stated that "while they [accounting standards] are not conclusive,... and they are not rigid rules as the explanatory foreword makes clear, they are very strong evidence as to what is the proper standard which should be adopted."

Following statutory recognition of the existence of accounting standards, the ASB requested Miss Mary Arden QC to write a further Opinion which addressed the legal relationship between accounting standards and the true and fair view. The Opinion was issued in April 1993 and published by the ASB as an Appendix to its Foreword to Accounting Standards. Whilst, this Opinion has been given in the

context of the changes in the law discussed above, it is essentially a reiteration of the two previous Joint Opinions. It again explains that "the immediate effect of the issue of an accounting standard is to create a likelihood that the court will hold that compliance with that standard is necessary to meet the true and fair requirement. That likelihood is strengthened by the degree to which a standard is subsequently accepted in practice. Thus if a particular standard is generally followed, the court is very likely to find that the accounts must comply with it in order to show a true and fair view. The converse of that proposition, that non-acceptance of a standard in practice would almost inevitably lead a court to the conclusion that compliance with it was not necessary to meet the true and fair requirement, is not however the case. Whenever a standard is issued by the Board, then irrespective of the lack in some quarters of support for it, the court would be bound to give special weight to the opinion of the Board in view of its status as the standard-setting body, the process of investigation, discussion and consultation that it will have undertaken before adopting the standard and the evolving nature of accounting standards."

Clearly, therefore, although accounting standards have no direct legal authority or effect, it appears highly probable that they will have a very persuasive effect in the courts' interpretation as to whether or not a company's accounts present a true and fair view. These developments impacted on the revision process of the hitherto existing Nigerian Companies Act which led to the enactment of the

Companies and Allied Matters Act of 1990. Today, although the NASB still does not have any legal muscle to enforce compliance or sanction non-compliance to its standards, non-compliance to its standards would certainly lead to the qualification of accounts by the external auditor.

The CAMA legislation made two issues, among others, mandatory: first, the Boards of Directors of companies are required to prepare periodic financial statements which comply, in form and content, with the generally accepted accounting principles (GAAP) and standards laid down in the Statements of Accounting Standards(SAS) issued from time to time by the Nigerian Accounting Standards Board (NASB); second, the shareholders were also required to appoint, at their Annual General Meetings, external auditors who were empowered by Sections 359(1) and Section 360(1) to examine the financial statements of companies and issue professional opinion on how well the complied with GAAP, Standards and other relevant legislations.

Although the attestation function involves ***the expression of an opinion*** on the financial statements prepared by directors and presented to shareholders as part of their fiduciary responsibilities, there is no section of the Act where the expression ***true and fair*** was used. It is reasonable to say therefore that it is purely a professional expression commonly used by accountants unlike the UK tradition where it is a legal requirement. Thus, the financial statements can be

said to be ***true*** in our context if they conform to GAAP, the relevant standards and other statutory requirements and do not contain any material misstatements or omissions.

It is important to stress that information is material if its omission or misstatements can influence the economic decisions of users taken on the basis of the financial statements. Thus, materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Since it provides a cut-off point or threshold, the level of materiality applied to each item of the financial statement may differ. Its selection is therefore a function of the professional judgement of the auditor. In addition, since many stakeholders rely on financial statements for various reasons, their preparation and presentation must be objectively and unbiasedly done. That is, they must be ***fair*** to all.

In line with this reasoning, I dare state that the expression true and fair is not synonymous to any entity's bill of health, whether clean or dirty! It only shows the correspondence of the financial information to the economic activity it seeks to describe and the objectivity exercised by management when processing it. It shows the absence of any misstatement, omission or breach of any statutory requirement. This view is reinforced by the fact that auditors are statutory required to examine financial statements prepared by directors in order to ascertain whether they are what they claim to be. Indeed, they represent the cumulative impact of the board of

directors' decisions on the resources of the shareholders over the financial year**.** Any decisions to be taken on the basis of audited financial statements must therefore be validated by an independent assessment of the investment forces at play. And this does not fall within the purview of the external auditor.

There is nothing in all the professional standards worldwide that provides the guarantee that absolute compliance with these procedures by the auditor will completely obliterate fraudulent practices and insider abuse in the system. If frauds (e.g., collusion by employees to inflate the cost of buying an asset) are perpetuated by those entrusted with the duty of protecting corporate resources in order to facilitate the wealth creation process the auditor can do very little. In fact ISA 240 "Fraud and Errors" states clearly that the ***responsibility for the prevention and detection of fraud and error rests with management through the implementation and continued operation of adequate accounting and internal control systems. Such systems reduce but do not eliminate the possibility of fraud and error. The auditor is not and cannot be held responsible for the prevention of fraud and error. The fact that an annual audit is carried out may, however, act as a deterrent.***

7. CONCLUSION

Clearly, the duty of the auditor is to give an opinion on the truth and fairness of the financial statements prepared by the directors who

also have responsibility for their presentational faithfulness. The auditor's opinion merely enhances the credibility of financial statements by providing a high, but not absolute, level of assurance since he can not foresee the future. Absolute assurance is not attainable as a result of such aforementioned factors as the need for judgement, the use of testing, the inherent limitations of any accounting and internal control systems and the fact that most of the evidence available to the auditor is persuasive, rather than conclusive, in nature.

Thus an audit, in accordance with International Standards on Audits (IAS), is designed to provide reasonable assurance that the ***financial statements taken as a whole are free from material misstatements***. The auditor does not issue financial statements or any financial statement analysis upon which investments are to be based. His role in corporate governance is to express a view as to whether or not the financial statements audited by him have been prepared consistently using appropriate accounting policies in accordance with relevant regulations, legislations and applicable accounting standards. The conformity or otherwise to these expectations enables the auditor to determine the truth and fairness of the reports prepared and presented to the shareholders by the directors. And this influences the thrust of his report and professional opinion.

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