THE "TRUE AND FAIR VIEW" CONCEPT IN BUSINESS AND TAX LAW: THE PORTUGUESE AND SPANISH CASE STUDIES

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CASE DESCRIPTION

The main goal of this paper is to understand how the "true and fair view" concept was incorporated in the Spanish and Portuguese national laws, comparing the national legal dispositions and understanding how this concept was accepted in each of these countries. For this purpose, the business and tax law of both European countries were investigated. In Spain, the Commerce Code (Código de Comercio), the Capital Companies Law (Ley de Sociedades de Capital), the Accounting law (Plan General de Contabilidad) and the Corporate Income Tax Law (Ley del Impuesto sobre Sociedades) were studied. In Portugal was made an analysis of the Code of Commercial Companies (Código das Sociedades Comerciais), the Securities Code (Código dos Valores Mobiliários), the Accounting law (Plano Oficial de Contabilidade and Sistema de Normalização contabilística) and the Corporate Income Tax Law (Código do Imposto sobre o Rendimento das Pessoas Coletivas).

The results show that the true and fair view concept was incorporated by both national laws, mainly because as member states of the European Union they were obliged to integrate it. This integration occurred in both business and tax law. The business legislation has a general understanding of the concept as an overriding principle, being the accounting principles simple means to reach it. In the corporation income tax law, this concept is implicitly recognized in both laws by inherent acceptance of generally accepted accounting principles under Articles 10.3 of the Ley del Impuesto sobre Sociedades and 17.3 of the Código do Imposto sobre o Rendimento das Pessoas Colectivas.

Keywords: True and Fair View, Accounting, Business Ethics, European Union, Portugal, Spain.

JEL Classification: K00, K20, K22, K34

CASE SYNOPSIS

It is right to assume that the main goal of accounting law legislators is the fair presentation of the financial reports. It means that the fundamental objective of financial statements is to give a "*valid picture*" of the entities' accounts and not a misleading one (Alexander & Eberhartinger, 2009).

Nevertheless, cases of fraud in financial reports are not recent. In the last decades of the twentieth century, the world witnessed several cases of companies that managed their financial statements. Some of these cases had worldwide repercussions. The purpose was to provide a false or misleading impression of the company's financial situation to the shareholders and other users (Melville, 2015). The motivations to present false financial information are several, between them the lack of leadership success, a reason that is related to "*monopolizing the decision-making process*" (Al-Abrrow et al., 2018).

In 2001 the Enron's case occurred. The dimension and consequences of this case had repercussions not only in the American financial system but throughout the world as well. This situation led to the fall of the firm that was responsible for the audit services, Arthur Andersen. At the time, the solution found was the approval of specific legislation the Sarbanes Oxley act. The main goal of this law was to improve the rules of corporate governance. This is a well-studied and documented case (Ahmed, 2018; Gwilliam & Jackson, 2008; Martin et al., 2014; Sanoran, 2018; Tang et al., 2018).

In the last decades, and more recently, in the last years, similar cases became known to the public worldwide. Portugal and Spain are no exception. In 2012, the case of Bankia SA made newspapers' headlines. Bankia SA is a Spanish Bank that faced a criminal investigation for falsification of accounts, among other crimes[1]. Following an account auditing to the bank's exercise of 2011, it was concluded that, in reality, the bank did not have a profit of €309 million but a loss of €4.3 billion before taxes[2].

Likewise, in Portugal, in 2014, the downfall of one of the largest and oldest banks in the country came to public notice the Banco Espírito Santo (also known as BES). This bank was part of the Espírito Santo Group. This situation led to great monetary losses for both shareholders and investors (Jayantilal et al., 2017). The group gave a misleading impression of the accounts, leading the users of financial information to think that the companies of the group had a healthy financial situation (Sharife, 2016). In 2013, a financial audit to the group took place and several irregularities in financial accounts were revealed. It was concluded that, against what had been reported by the group, the bank faced bankruptcy (Almeida et al., 2014).

Many other cases similar to Bankia SA and Banco Espírito Santo happened in other countries. They emphasize how relevant and fundamental it is to analyze and remember the importance of the true and fair view (henceforth TFV) concept. The educational institutions understand the relevance and interest in studying these cases as they occur and there are a lot of recent studies of identical irregularities (Avi, 2017; Ciocan, 2017; Gonzalo-Angulo et al., 2018; Ho, 2016; Mariana & Maria, 2016).

As Epaves (1977) said "*the objectives of financial statements are inexorably related to a "true and fair view" of an entity*". The financial reports have as underlying the basic notion of TFV. Users need to be assured that this concept is fulfilled in order to understand the legitimacy and the righteousness of the statements (Avi, 2017).

It is why this concept has been investigated by scholars, namely regarding its application in national laws of European Union member states. Walton (1993) investigated the true and fair view of British accounting. Kosmala (2005) described the recent developments in Polish accounting and discusses its implications for the realization of TFV. Alexander & Eberhartinger (2009) studied the concept of TFV in the European Union making the relationship between the EU and national laws, using Austria as a case study. Therefore, it possible to conclude that although there are some studies about the issue, the theme is still underexplored and to the best of our knowledge there are any studies on the Portuguese and Spanish cases.

In particular, there is a need to better understand how the "*true and fair view*" concept was incorporated in the Spanish and Portuguese national laws, in particular in business and tax dimensions. This research addresses this gap by studying the legal norms that approached the TFV. The research questions tackled by the study are: How was the true and fair view concept incorporated by the national laws of Spain and Portugal. What are the differences and similarities when we compare the two cases? For this purpose, the most relevant Spanish and Portuguese legal norms were examined.

This paper is composed of six sections. First, the introduction, in which the framing of the subject is done and where it is explained why it is important and updated to study this concept. Second, an analysis is made of the evolution of the true and fair view concept. In the third section is done an examination of the Spanish national business and tax law and the corresponding effort to reflect the TFV concept. It is a historical analysis. After, in the fourth section, the TFV in the Portuguese business and tax law, where a historical view is also presented. Next, in the fifth section, a comparison of the actual legal disposition between both jurisdictions. Finally, in the sixth section, the conclusions.

THE EVOLUTION OF THE "*TRUE AND FAIR VIEW*" CONCEPT

The importance of guaranteeing that what accounts statements show corresponds to the truth is not recent. It was possible to read in several auditor's reports from the United States expressions as "*presents fairly in conformity with generally accepted accounting principles*". Also, in accounts' reports from companies in the United Kingdom the term "*true and fair view*" was common usage. Later, under the tradition in the United Kingdom, the Commission of the European Communities issued a document entitled "*Amended Proposal for a Fourth Council Directive*". This document assumed the usage of the term "*true and fair view*" for British reports (Epaves, 1977).

Consequently, this concept was adopted by international accounting organizations. The conceptual framework of the International Accounting Standards Committee (IASC) recognized the faithful representation as a qualitative characteristic of financial statements. In the same way the International Accounting Standards Board (IASB) also assumed the faithful representation as a qualitative characteristic fundamental of the financial information. The conceptual framework of IASB defends that the financial information must faithfully represent the transactions and other events that it is supposed to represent. A perfectly faithful representation would be complete, neutral and free from error (Melville, 2015).

In Europe, the true and fair view of financial accounts was considered as a "*common standard*" by the European Union. Nevertheless, organisms, such as the IASC and IASB, were not concerned in determining a standard definition of it (Dragneva & Millan, 2002). This concept was incorporated in accounting rules, first by the Fourth Directive[3], determining that "*annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss*"[4]. Later, this concept was reaffirmed in the Seventh Company Law Directive[5].

The meaning of the TFV concept was studied from many perspectives (Epaves, 1977; Flint, 1982; Rutherford, 1985). This concept is based on "*a philosophical concept and not susceptible to definition by a comprehensive set of detailed rules*" (Flint, 1982). It includes both "*fairness of presentation*" and the "*recognition of economic substance rather than mere legal form*" (Rutterman, 1984). Since there is no theoretical and legal definition for the TFV concept (Pasqualini, 1992), nor a uniform practical application (Francisco, 2013:2015), its consensual definition is very controversial and difficult to achieve.

Rutherford (1985) and Epaves (1977) consider that the TFV is a concept whose meaning should be determined by empirical analysis and not under a theoretical framework. It means that the court's readings and wording ordinary application can be an alternative source of orientation.

In 1994, the European Court of Justice sustained, in the case *Tomberger vs. Gebrüder von der Wettern*[6], that the main goal of the Fourth Directive was the true and fair view of accounts. It means the protection of the principle that accounting must show a faithful representation of the entities' financial situation.

By analyzing literature it is possible to understand that sometimes the true and fair view is considered as an overriding principle, but other times it is regarded as a parameter. The TFV appears as a principle of legal superiority (Francisco, 2013). It should be understood as the enforcement of the generally accepted accounting principles restrained in company law and the accounting standards' statements (Nobes & Parker, 1991; Rutterman, 1984). To Kling (2006) the true and fair view represents one of the most important revolutions in accountancy domain. Sánchez & Pereda (2010) refer to the "*derogatory character*" of the TFV. It means that when the application of specific accounting criteria is not compatible with the main proposal of showing the accounts TFV, that criterion should not be applied.

Francisco (2013) considers that it is a parameter to evaluate the quality of the financial statements. It is used to understand if the companies' financial reports have any material errors on the application of accounting standards, and they are available to show the real financial situation of the companies. The same author holds that it intends to verify whether it was possible to obtain a true representation of the financial position of the accounts of an entity and whether it faithfully portrays the past financial events of that entity. If this condition is verified it is possible to conclude that the true and fair view is fulfilled as an overriding principle.

The accountancy reports mirror old economic transitions. Future events can be also reported, exceptionally. It happens when it is very important to understand financial information to give a true and fair view of financial accounts' reports (Nobes & Parker, 1991).

The several users of the accounts of the entities have an ordinary knowledge about the main objective of the accounts' reports and an ordinary knowledge that the accounting criteria options are decided by managers, confirmed by auditors and are to be taken into consideration by financial reports' users, always having as underpinning their faithful representation (Nobes & Parker, 1991).

All countries that are members of the European Union must show a true and fair view of the financial situation and the entities as well as their profit or loss. Spain and Portugal included (Nobes, 1993; Sánchez & Pereda, 2010).

In this conceptual background, this research aims to address two questions:

1. How was the true and fair view concept incorporated by the national laws of Spain and Portugal?
2. What are the differences and similarities when we compare the two cases?

Table 1
THE CASE STUDIES OF PORTUGAL AND SPAIN

Spain		**Portugal**
Business Law	Commerce Code (*Código de Comercio-Real decreto de 22 de agosto de 1885*).	*Code of commercial companies (Código das Sociedades Comerciais–Decreto-Lei n.º **262/86).***
	Capital Companies Law(Ley de Sociededes de capital-Real Decreto Legislativo 1/2010, de 2 de julio).	Securities Code (*Código dos Valores Mobiliários–Decreto-Lei n.º 486/99).*
	Accounting Law (Plan General de Contabilidad-Real Decreto 1514/2007, de 16 de noviembre).	Accounting Law (*Sistema de Normalização Contabilistica–Decreto de Lei n.º 158/09 de 13/07).*
Tax Law	Corporate Income Tax Law (*Ley dal Impuesto sobre Sociedades–Ley 27/2014, de 27 de noviembre, raglamento del Impuesto sobre Sociedades–Real Decreto 634/2015, de 10 de julio*).	Corporate Income Tax Law (*Código do Imposto sobre o Rendimento das Pessoas Colectivas–Lei n.º 2/2014 de 16 de janeiro).*

In order to answer them, a comparative analysis of legal structures of the European Community was presented, in specific, the case studies of Portugal and Spain (Table 1). Several Spanish data sources were included: the Commerce Code; the Capital Companies Law; the Accounting law; and the Corporate Income Tax Law. A large number of Portuguese sources of documentation were also used: the Code of Commercial Companies; the Securities Code; the Accounting law; and the Corporate Income Tax Law.

THE "TRUE AND FAIR VIEW" CONCEPT IN THE SPAIN BUSINESS AND TAX LAW

The TFV concept was incorporated in the Spanish law a long time ago. Already in 1951, the Spanish Law of Anonymous Societies[7] had recognized the importance of preparing the balance sheet with enough clearness to allow the knowledge of the companies' financial situation. Later the obligation to reflect the true and fair view[8] became mandatory due to the Spanish integration in the European Union (EU) through the Fourth Directive (Calvo, 2006).

This concept was assumed by the Spanish Commerce Code[9] (henceforth CC) of 1885, modified in 1989. This change determines that balance sheets and income statements should show with clarity and exactitude the company's equity. Article 34.2 considers that the annual accounts should be prepared with clearness to present with equity the true and fair view, and therefore, the financial situation and company's profit. For this, the accounting operations should attend to economic reality and not only to legal form.

According to article 34.3 of the Spanish CC, if the legal dispositions don't give enough information to show the faithful representation, the additional information should be given in financial statements.

Article 34.4 of the same legislation predicts about exceptional cases. If the application of a legal disposition in accounting is incompatible with the true and fair view of the annual accounts, such disposition should not be applied. In these cases, the report should indicate this lack of application, it should sufficiently explain what motivated the exception and explain as well its influence on the equity, financial situation, and the companies' results.

In article 38.i) of the same law, the strict non-application of some accounting principles will be admitted when the relative importance of the variation produced by such event is scarcely significant and, consequently, does not alter the expression of the true image of the assets, the financial situation, and the results of the company[10].

In this sense, the Spanish CC expressly determines the concept of TFV as an essential point of reference for accounting principles. It has as underlying the principles and accounting norms issued by the Spanish Association of Accounting and Business Administration[11] (Calvo, 2006).

The Capital Companies Law[12] has also recognized this macro principle in similar terms. Article 254 refers to how the annual accounts should be prepared. Otherwise, the Spanish accounting law[13] determines that the annuals accounts should be written with clarity, the supplied financial information should be comprehensible and be useful to help several stockholders to make economic decisions. It also must show the true and fair view of equity, the financial situation and the companies' profits, having in consideration the legal dispositions (Constans, 2012).

To reflect the true and fair view, the PGC (*Plan General de Contabilidad*) demands a systematic and regular application of requirements, principles and accounting criteria which should lead to annual accounts that show the true and fair view of the companies' equity, their financial situation and profit. In case they are insufficient, the norm obliges to provide additional information in order to achieve the objective. As the law defines the main goal of accounting the faithful representation of the companies' equity it can, therefore, consequently, be considered as a super-principle. In this case, other accounting principles are simple means to reach this one goal.

The Spanish corporate income tax is estimated to have as underlying the accounting profit. It means that except the corrections provided for by law; the result is determined by the accounting that is taken for the purposes of corporate taxation (Ortega, 2015). The determination of corporate profit needs to observe several principles known as Generally Accepted Accounting Principles, or GAAP, as well as the macro principle of true and fair view. So, if the corporate tax law assumes the companies' profit, it means that the accounting principles are designed for the tax domain (Pereira, 1988). This subjection is designed for the tax domain through article 10.3 of Spanish corporate income tax[14].

By reviewing the Spanish corporate income tax it is possible to find an express reference to the true and fair view in article 11 of the LIS (*Ley del Impuesto sobre Sociedades*). Article 11.1 refers that the economic revenues and expenses are recognized in the periods in which they occur and not recognized in the period in which cash is received or paid. The tax law assumes the accrual basis accounting principle as the main goal (Berman et al., 2013; Melville, 2015; Pascual & Zamora, 1998).

Article 11.2 of the LIS denotes that when there is the necessity to not respect the accruals basis and resort to different criteria for temporary imputation of income and expenses, in order to attach the faithful representation of the financial situation, the company must have the authorization of the tax authority. Article 1 of the Regulation of Spanish Corporate Tax[15] identifies the condition for the approval of temporary imputation criteria, besides the accrual basis. Article 1.2.c), in particular, refers the requirement to present valid argumentation that the proposed temporary imputation criteria have as main goal the true and fair view of financial accounts. It is also required to explain how this option will influence the company´s equity, the financial situation and the profit.

THE "TRUE AND FAIR VIEW" CONCEPT IN THE PORTUGUESE BUSINESS AND TAX LAW

The Portuguese translation of "*true and fair view*" is *imagem verdadeira e apropriada* (Nobes, 1993). In the old Portuguese accounting law, the Plano Oficial de Contabilidade, commonly known as POC, it was easy to find references to the true and fair view concept. First, the POC referred that the observation and compliance of the qualitative characteristics of financial information, the concepts, the accounting principles and the accounting standards in the financial statements show the true and fair view of the financial position and profits of the companies (Borges et a., 1998). Afterward, it expressly refers that the fundamental accounting principles are indicated with the goal to obtain the faithful representation of financial accounts (Bento & Machado, 2008).

In 2005, with law 35/2005, 17 February, Article 451.3.c) the Code of Commercial Companies[16] changed. This article treats the examination of accounts in companies with fiscal council and audit committee. The new wording changed and went on to mention that as result of the examination of the accounts the auditor must issue a legal certification of accounts, which should include an opinion on whether the accounts for the financial year give a true and fair view.

In 2007, with law 357-A/2007, 31 October, the Portuguese Securities Code[17] changed the wording of some articles, specifically articles 245, 246 and 305. Article 245 and 246 assume that financial reports of the issuers of shares and securities must show a true and fair view of the assets and liabilities, financial position and results. Article 305 determines that the financial intermediation activities must adopt an accounting organization which enables it, at any time and in an immediate manner, to make timely submission of financial reports which reflect a true and fair view of its financial situation and which comply with all applicable accounting rules and regulations.

Later, in the prevailing accounting law[18], the SNC (*Sistema de Nomalização Contabilística*), the concept of true and fair view is referenced in paragraph 46 of the conceptual framework. It says that the application of the main qualitative characteristics and appropriate accounting standards usually results in financial statements that convey what is generally understood to be a true and fair view or reasonably presented as such.

Article 8 of the SNC[19] refers to the situations in which the companies are excluded from consolidation. An entity can be excluded from accounting consolidation when it is not relevant to achieve the main goal, which is to give a faithful representation of the group's financial equity (Rodrigues, 2015).

In the Portuguese corporate income tax[20], the CIRC (*Código do Imposto sobre o Rendimento das Pessoas Colectivas*) it is not possible to find an express reference to the studied concept but, for tax proposals, it is applicable for remission of the article 17.1 of the CIRC. This disposition presumes its automatic acceptation in tax law. This means that when the net profit is accepted as a starting point to the determination of the tax profit, then the tax law is accepting the accounting assumptions on which the accounting result was based, so the tax base itself respects the true and fair view (Pereira, 1988; Sanches, 2007).

FINDINGS

Early Spanish law assumes the importance to show a fair representation of financial statements. This happened in 1951, and Portugal did not follow this evolution at the time. The wording "*true and fair view*" was incorporated by both countries later, in 1989. The incorporation of this concept occurred due to the obligations imposed on Portugal and Spain when they became members of the European Union.

The importance given by the Spanish CC to the concept TFV is very obvious. In the Spanish law this wording is invoked fourteen times, against only once on the Portuguese CSC (*Código das Sociedades Comerciais*).

The text of the Spanish CC determines that the financial annual accounts must expressly show the true and fair view. It makes a lot of considerations about this concept, including about individual and consolidated accounts. While in the Portuguese CSC it is done implicitly and only when the auditor's obligation to refer the accounts' faithful representation for the legal certification is mentioned.

The Spanish LSC recognizes the relevance of this concept so it sustains a similar disposition to the Spanish CC. However, in Portugal, the CSC only refers about the auditor requirement for the enforcement, or not, of this TFV in financial reports. This means that it only makes a general reference assuming it as an underlying overriding principle.

In accounting law, Spain adopts the same understanding already studied by the Spanish business law. Portuguese accounting law refers the TFV but considers this concept as an implicit overriding principle and does not develop it in the legal dispositions.

The Spanish corporate income tax law is aligned with its business tax law dispositions. Also, in LIS, it is possible to find the expression "*true and fair view*" explicitly. In the Portuguese corporate tax law this concept is implicitly present, and it is not possible to find the wording itself (Table 2).

Table 2
PORTUGAL AND SPAIN ARTICLES

Spain		**Articles**	**Portugal**	**Articles**
Business Law	Commerce	34.2;34.3; 34.4;38.[1]	*Code of commercial companies*	*451.3.c*
	Capital Companies Law	*254*	Securities Code	245;246;305
	Accounting Law	*Not Applicable*	Accounting Law	§46 Conceptual Framework; Article 8 SNC
Tax Law	Corporate Income Tax Law	10.3 LIS; 11.1 LSI; 1.2.c RLIS	Corporate Income Tax Law	17.1

CONCLUSION

Officially, the TFV concept was assumed by both countries in 1989, with changes in legal dispositions. Spain explicitly assumes the expression with a legislation change in the Spanish Commerce Code and later in accounting law; Portugal acted in the opposite way, first with an alteration in accounting law and only after in the Portuguese Commercial Code.

It seems clear that the TFV, in both these members of the European Union, is seen as an overriding principle, with no legal and theoretical definition, and that it is observed with the enforcement of the generally accepted accounting principles imposed by business law.

With respect to corporate income tax laws, the guidelines do not differ in any materially relevant situation. In both jurisdictions, the faithful image is considered as a Macro Principle. It is implicitly accepted in the LIS and the CIRC, by inherent acceptance of generally accepted accounting principles under articles 10.3 and 17.1 (a), respectively.

Spanish business and tax law have the concept TFV expressly more present using the term several times. Portuguese business and tax law only refer to the TFV concept implicitly throughout the law dispositions. For both countries it seems clear that it is considered as an overriding principle to be respected in order to present the entities financial reports' fair presentation.

With this paper, it was possible to understand how the TFV concept was incorporated in the national laws of Spain and Portugal. The national legal dispositions were analyzed and an effort made to understand the acceptance of the TFV in both countries. However, the fact that the investigation presents as case study only Portugal and Spain it is a limitation of it, as well as, it is a descriptive and exploratory investigation because only analyses the legal norms of both countries.

It would be interesting, as future research, to develop the tax assessment and to analyze how the TFV concept was approached by the courts' interpretation of EU's state members as Spain and Portugal, as well as in other countries.

ENDNOTE

1. https://www.thetimes.co.uk/article/the-bankia-banker-who-didnt-understand-anything-g2gf8kn5rjx
2. https://en.wikipedia.org/wiki/Bankia

3. Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, Official Journal L222, 14.08.1978 p.11.
4. Article 2 (3) of the Fourth Company Law Directive.
5. Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, Official Journal L193, 18.07.1983 p.1.
6. Case C-234/94 [1996] ECR I-3133.
7. Régimen Jurídico de las Sociedades Anónimas-Ley de 17 de julio de 1951 (LSA).
8. The Spain translation of "*true and fair view*" is imagen fiel (C. Nobes, 1993).
9. Código de Comercio-Real decreto de 22 de agosto de 1885 (CC).
10. The application of TFV concept in the consolidated accounts, see articles 43.3, 44.2, 45.2 and 48 of the Spain CC.
11. *Asociación Española de Contabilidad y Administración de Empresas* (AECA). AECA recognise the true and fair view principle as an overriding principle. This recognition is sustained of European dispositions. According to this organism, the conjugation of the interpretation of companies' economic framework with the characteristics and requirements to accounting information, leads to the true and fair view of financial accounts. The preparation of financial statements under accounting principles leads to present the true and fair view of companies' financial accounts (AECA, 1980).
12. Ley de Sociedades de Capital-Real Decreto Legislativo 1/2010, de 2 de julio (LSC) .
13. *Plan General de Contabilidad-Real Decreto 1514/2007, de 16 de noviembre (PGC).*
14. *Ley del Impuesto sobre Sociedades-Ley 27/2014, de 27 de noviembre (LIS).*
15. *Reglamento del Impuesto sobre Sociedades-Real Decreto 634/2015, de 10 de julio. (RLIS).*
16. *Código das Sociedades Comerciais-Decreto-Lei n.º 262/86* (CSC).
17. *Código dos Valores Mobiliários-Decreto-Lei n.º 486/99* (CVM).
18. *Sistema de Normalização Contabilística-Decreto de Lei n.º 158/09 de 13/07* (SNC).
19. *Decreto-Lei n.º 158/2009.*
20. *Código do Imposto sobre o Rendimento das Pessoas Colectivas-Lei n.º 2/2014 de 16 de janeiro* (CIRC).

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