

February 17, 2015 11:33 pm

Committed to standards reflecting economic reality

Sir, Some investors bemoan International Financial Reporting Standards (IFRS) for their alleged lack of prudence and excessive reliance on mark-to-market accounting (Letters, February 16). Their diagnosis of IFRS as a major contributor to the financial crisis is mistaken and their recipe will mislead investors.

Only last month, the Basel Committee on Banking Supervision, which has always been very critical of mark-to-market (fair value) accounting, concluded on the basis of exhaustive research that there is little evidence that fair value accounting played a role of any significance in the financial crisis.

Furthermore, just before the crisis, the IFRS accounts of banks showed very clearly that most of them had next to no capital. The fact that many market participants chose to ignore the extreme leverage of the banking system is a typical case of not seeing that the emperor was wearing no clothes. To blame accounting after the fact is not very convincing.

The signatories to Monday's letter would like us to replace neutrality with prudence as the guiding principle of our Standards. They seem to believe that rather than portraying economic reality as transparently as possible, our Standards should have a consistent bias towards conservatism.

The International Accounting Standards Board intends to reintroduce an explicit reference to prudence into its conceptual framework, but in support of neutrality, not to replace it. We agree that understatement of liabilities and overstatement of profits need to be avoided. However we, as well as many of the investors we speak to, are also convinced that deliberate understatement of assets and profits is equally imprudent.

The creation of hidden reserves in good times enormously increases the temptation of artificially inflating earnings in bad times. No investor is served by increasing the scope for earnings management. The IASB will therefore remain committed to creating Standards that reflect economic reality as closely as possible.

Hans Hoogervorst

Chairman, International Accounting Standards Board (IASB)

Letter in response to this letter:

IASB is still unable to respond to criticism / From Stella Fearnley and Tony Hines

Further research is warranted / From Stefan Ingves

Printed from: <http://www.ft.com/cms/s/0/168510c8-b69e-11e4-a5f2-00144feab7de.html>

Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

© THE FINANCIAL TIMES LTD 2015 FT and 'Financial Times' are trademarks of The Financial Times Ltd.