Central bankers demand new accounting rules on bad debt

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FT.com / Companies / Banks - Central bankers demand new rules.

The FT notes:

Top central bankers and regulators underlined their differences with accounting rule-makers on Monday over the way banks account for bad loans, highlighting the politicisation of the standard-setting process.

The central bank governors and heads of supervision of the world's largest economies, who oversee the Basel Committee on Banking Supervision, said it was "essential" that accounting rule-makers and their supervisors develop a "truly robust" approach on banks' provision for bad loans.

As the FT also notes:

Their six-point plan, which focuses on accounting for expected losses, clashes on several points with proposals laid out in November by the International Accounting Standards Board, the rule-setter for most of the world outside the US.

This was becasue:

The oversight body's proposals would, crucially, lead to more smoothing-out of bank profits through the financial cycle than the IASB proposals would allow.

This, I stress is not a minor difference. This is the two bodies being fundamentally at odds with each other and with the IASB being absolutely in the wrong.

The IASB promotes the mark to market model. This is the absolute reverse of what accounting used to be when it came to bad debts. Accountants always used to anticipate losses on debts and make provision for them. This was prudent.

But come mark to market and securitised loans so long as there was a market for the security no provision for loss was allowed EVEN IF the underlying assets were obviously not performing: the market ruled value and prudence could not overtake. So there was no provisioning. Imprudence ruled. Losses could only be recognised when they had occurred with regard to the vast majority of bank debt.

So, of course, IFRS accounts allowed bank profit to sky rocket as loss provisions fell.

And then the world fell apart because bankers believed they could lend and never make a loss.

That is completely and utterly the fault of the International Accounting Standards Board.

No wonder Basel disagrees with them.

And Basel has to win this one. And all accountants should support Basel because prudent may be boring but it's what good accountancy is about.

PS And you can't blame the auditors - the Big 4 ensured the rules of auditing were changed so they no longer had to be prudent either - because they no longer had to say accounts were true and fair - they just had to say they were true and fair within IFRS - which meant that even if IFRS were nonsense they had no duty to apply what used to be called the 'true and fair over-ride' because that no longer existed.

Blame the IASB by all means. But let's never forget that the IASB is the mere agent of PricewaterhouseCoopers, Deloitte, KPMG and Ernst & Young. And they are really to blame.