

The time to scrap IFRS accounting has arrived

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The FT has two [articles](#) this morning [highlighting](#) the failure of accounting rules to handle the impact of the coronavirus crisis, most especially in banking.

The problem that is being faced has persisted since 2005 when International Financial Reporting Standards were introduced as the de facto accounting standard system for the UK, the EU and over 100 other countries.

This is not the moment to critique the multitudinous failings of IFRS accounting, although they exist. It is instead the moment to note that they are the very opposite of the reasonably objective standards for reporting that any user of accounts might require, most especially at times like this.

The current problem relates to loss reporting. As Jonathan Ford [notes in the FT](#), when IFRS reporting was introduced the rules on loss reporting were absurdly relaxed:

You may remember the issue that emerged in 2008. Banks hung back from revealing their losses on loans because they claimed the standards then in force required them only to provide for losses when a loan was actually at, or on the threshold of, default.

That's why, say, Bank of Ireland was able to publish a clean set of accounts in the summer of 2008, just months before heeling over and having to request a €5bn bailout.

The result was bank accounting that helped deliver the 2008 crash because insufficient accounting warnings were given. That is a big charge to lay. It is wholly justified.

Reform has happened. This is in what is called IFRS9. The trouble is the reform is also deeply flawed, largely by being too formulaic, and by (as is normal in IFRS accounting) ignoring the time dimension as to what is happening and instead accounting for all the consequences as if they happen in the present, when that is not the case. Jonathan Ford describes this, and I will not reiterate it.

Suffice to say IFRS9 is also considered to be failing. That's partly because it is resulting

in the reporting of a great many losses and that means banks could fail the supposed stress tests that central bankers so recently said they passed. Of course, these losses may be real. Who knows? The accounting system will not let us know. And that is because, as the FT also reports, the Bank of England and its agencies are encouraging a lax approach to the accounting.

None of this is remotely acceptable, of course. It's bad enough having bad rules. It's worse when bad rules are known to exist and so encouragement is provided to apply them badly.

So what do we need? The answer seems very clear. Historical cost accounting has a simple heuristic test for addressing this issue, which along with much else in that approach to accounting (which was abandoned in favour of IFRS) worked. The rule was that all assets should be valued at the lower of cost or net realisable value.

The cost of a loan was the sum advanced.

The net realisable value was the net sum now likely to be recovered from the advance, ignoring interest to be earned that should be allocated to future accounting periods.

And, if there was doubt prudence required that a provision be made. Reinstatement thereafter was not permitted. That stopped game playing.

This rule would work now.

It is the rule we need now.

We need prudence back now.

We need to scrap IFRS for many reasons, but this is an excellent example. Accounting is about the application of clear logic to uncertain situations where clear guidance as to the required decision criteria (i.e. prudence in this scenario) can be given so that the likelihood of the opinion formed being capable of replication is high. That is as close to objective reporting as accounting can get.

IFRS accounting is far removed from that. That is why it has to go. Dithering on this issue is no longer needed. We know how to account properly. Historical cost accounting worked well for everyone barring management in pursuit of the overstatement of profits for their own ends.

Let's now scrap this neoliberal form of accounting that is intended to misinform and go back to accounting that does not in that case. We might then get some reasonably objective data on which to base decisions during this crisis. That is the last thing we are going to get right now.