

Accountants were told to turn a blind eye to bank accou...

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The [FT has noted](#) that:

The UK's banking regulator has told lenders not to assume that extending repayment holidays amid the coronavirus pandemic will increase their risk of losses, marking a renewed bid to prevent accounting rules restricting the availability of credit.

They added:

On Monday, Sam Woods, chief executive of the Prudential Regulation Authority, sent a second 'Dear CEO' letter to the bosses of UK banks. It laid out guidance on how to treat loans if customers seek to defer their repayments for longer than the initial three-months period permitted in March. The letter followed confirmation earlier this week by the Financial Conduct Authority that such extensions should be granted, if borrowers are unable to make full repayments due to virus-related disruption.

Importantly, they note:

As a result, banks are having to carry out new assessments of the credit risk attached to deferred loans. The PRA does not want this process to automatically result in the loansâ€‰being classified as carrying "significantly increased credit risk" or being impaired. That would force the banks to book higher loss provisions under the international accounting standard known as IFRS 9 - thereby increasing their capital requirements and reducing their scope to lend.

This worries me, enormously. In 2008 auditors did, in effect, ignore the collapsing balance sheets of banks and issued audit reports that suggested that they were going concerns when only months later they collapsed, almost all of them requiring some form of financial support, or nationalisation, to survive. The auditors did this because they were given a nod and a wink and were told to ignore what was happening on the basis that the government would bail the banks out, of which likelihood they were told. The result was that accounts were grossly misstated at the time, and investors and the public were seriously misled.

It now looks very likely that a similar misstatement is being encouraged on this occasion. There is good reason why new accounting regulation requires that banks anticipate losses. This is precisely because the failure to do so has led to the overstatement of bank profits and the overstatement of their assets which is given a false impression of their viability. There is absolutely no advantage to society, investors, or anyone else of having a false impression of the security of our banks, and yet, very clearly, regulators are now telling banks that they should misstate their asset worth, and so overstate their income, by ignoring the potential losses that COVID-19 is creating for them.

To pretend in the current economic environment that those who have asked for loan payment deferrals with regard to mortgages and other liabilities will, somehow, be able to resume all their payments when the immediate first crisis period is over is absurd. Most of those who have asked for loan deferral will have good reason to do so. They will have either already lost their jobs, or their income as self-employed people, or are furloughed. And, on any reasonable basis of appraisal, many of those in this situation are not going to return to work with the levels of income that they enjoyed before this crisis developed. Indeed, many will be unemployed. In that case a great many of them will not be able to afford the liabilities they took on in the entirely different economic era. But banks are being told to presume that we will have a V shaped recovery and that everything will go back to normal, as if this was just a blip.

Very, very few economists believe that this is true. The vast majority think that we are going to face a very long recession, if not a slump. In that case it would be entirely reasonable for the banks to presume that many of those who are asking for loan deferrals now will not be able to settle their liabilities in full, and as such losses should be anticipated. If that is not happening because the PRA has said that it is not necessary then the PRA is being negligent by directing banks to misstate their financial results. I cannot put it more subtly than that, and I would describe this as gross failure by a regulator at a time when we really do have to have faith in them, which makes this doubly bad news.

Worse, deferring the bad news will simply mean that bigger bailouts will be required in the future.