

## IASB promotes 'fair value' rule change

By Jennifer Hughes

Published: July 14 2009 19:19 | The Financial Times Limited 2009

A radical shake-up of how banks and insurers report the value of financial instruments has been proposed by international accounting rule-setters in a bold attempt to resolve an intense dispute at the heart of efforts to prevent a repeat of credit crisis.

The [International Accounting Standards Board](#) has proposed a simple principle for whether banks and insurers should value a financial investment as a long-term holding or as a trading position.

The proposals could see more investments reported at current market values, a shift which could improve the transparency of accounts but increase volatility in earnings.

[Under the IASB's proposed rules](#), if a bank's investment produces predictable cash flow like a government bond, it can be valued in accounts using an accounting mechanism that smooths out market fluctuations. If the investment's cash flow is unpredictable, like some derivatives, it should be valued at current market levels.

The proposals are a riposte to a transatlantic push to water down "fair value" accounting, valuing assets at market levels. Some banks and policy makers believe the "fair value" creates unnecessary volatility in earnings, contributing to a loss of investor confidence at the height of the credit crisis when plunging asset prices hit balance sheets.

The new rules reframe that debate by giving banks more freedom in how they report assets but underlines the principles of using market prices where possible.

However, they would force banks and insurers to completely reassess how they report their investment portfolios.

For example, a portfolio of US Treasury bonds – among the most liquid assets in the world – can be classified as trading instruments and would be reported at fair value, just as they are now.

But a bank or insurer that held some of those same bonds as long-term investments could instead choose to report that part of its portfolio at "amortised cost", a process that removes market volatility from reported values.

"The proposals recognise that banks manage their portfolios differently and that's a huge step in the right direction," said Pauline Wallace, partner at PwC.

"This is a fundamental area of accounting and we need to get this right."