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Accounting

Volcker Heartened by Rulemakers' Reaction To Crisis, Warns About Dangers of 'Isolation'

NEW YORK—Paul Volcker, the former chairman of the Federal Reserve Board, praised the International Accounting Standards Board and its U.S. counterpart Oct. 29 for reacting to the financial crisis sensibly, as he also warned against the dangers of isolation presented by notions of independence and the specialized world in which rulemakers work.

Speaking at a conference on international accounting standards, the former Fed chief and former head of IASB's parent body also voiced a hope that the Securities and Exchange Commission would move soon to take action to confirm or modify its road map proposal that would call for U.S. public companies to possibly shift to standards issued by IASB.

Volcker congratulated the international panel and the Financial Accounting Standards Board as well "for taking into account—not in any knee-jerk way, responding to political pressures—but reexamining the way the standards should apply in a complex international and business world."

Volcker, a critic of fair-value accounting, spotlighted the need, in his view, for accounting standards to mesh with banks' "business models."

That stance is contested by some accounting rulemakers—most notably by James Leisenring, an IASB member and former FASB vice chairman. Leisenring has said he sees the business model as "a euphemism for free choice" (177 DTR G-8, 9/16/09).

"What we need, I think, is an accounting standard that may be entirely appropriate for a trading operation," said Volcker, "but not necessarily the same accounting standard that we need in other areas, for other kinds of business models with different characteristics and long-term relationships."

In the eight months after the financial meltdown of the late summer of 2008, both IASB and FASB issued guidance that effectively eased the reporting of mortgage-backed securities for banks holding toxic assets in markets that had come to a standstill. Much of that focus was on fair value reporting, and clarifying fair value measurement guidance; reclassification of debt securities; and, in the United States, when to take impairments or write-downs on certain securities.

A number of investor advocates, as well as several accounting rulemakers, also believe the boards went too far, or at least moved too quickly, last November through April in alleviating bankers' concerns about fair value reporting, classification, or impairment. Members of the U.S. Congress and the European Commission, in turn, forwarded those concerns directly to rulemakers such as IASB Chairman David Tweedie and FASB Chairman Robert Herz in official proceedings.

Volcker Encouraged

Volcker, who was the first chairman of IASB's parent group, suggested at the two-day conference here on international financial reporting standards that he was encouraged by progress made to date on both the writing of high-quality standards and their increasing acceptance worldwide. The conference was sponsored by the American Institute of Certified Public Accountants and IASB's parent, the International Accounting Standards Committee Foundation.

Volcker spotlighted movement toward increasing adoption of international financial reporting standards and continuation of action on convergence.

“I do hope the IASB and FASB can overcome their remaining differences as soon as possible,” Volcker said.

Volcker did not mention specifically the most apparent source of differences between the two boards in recent months: their joint project on financial instruments, in which FASB has called for a more visible role for fair value-based measurements than IASB.

However, he addressed the topic of financial instruments immediately after his comment on FASB and IASB coming together.

“I think IASB has made real progress in bringing its infamous IAS 39 up to date to better reflect the realities of a complicated world,” said Volcker. International Accounting Standard 39—crafted and revised several times by IASB under pressure from European bankers and the European Commission—covers financial instruments.

In a brief BNA interview after his Oct. 29 speech at the conference, Volcker said he felt better about the state of international accounting standards today than he did before the onset of the financial crisis. He suggested that accounting rulemakers had stepped up to the plate.

“I feel better now than I did two years ago,” said Volcker. “Obviously, it was a big challenge to the profession, to the standard setters.

“I think it shook up things, but in a constructive way,” he said of the financial crisis and its effect on standard setting. Confirming that at least some of his comments at the conference were in the context of financial instruments, Volcker said his general focus was on how you apply so-called fair value to financial institutions that have “non-marketable securities” and faced “confused markets.”

Beware ‘Cocoon' of Professional Isolation

As chairman of IASCF trustees from 2000-05, Volcker said, he was barred from speaking on the substance of rulemaking topics before the international board. However, four years after his service ended, the statute of limitations had run its course, he said.

Speaking more freely, Volcker focused on the need for IASB and rulemakers to be independent. Along those lines, he listed other words that expressed desired qualities in rulemaking: “professionalism,” “expertise,” and “uniformity,” which he said also reflected good values in central banking.

“But I think it's also true that the accounting standard setters—and whether you're talking about economists” or central bankers, he continued, “you know an organization that is shrouded in independence can also become a kind of professional cocoon. It can slip into isolation—even, may I say, arrogance.

“In that respect, it is subject to some of the dangers of central banking, and think of themselves as some high priest, or some occult science that ordinary mortals should not touch,” said Volcker. “But the fact is they have to deal—central bankers, or accountants or standard setters—with some really complicated realities that don't always fit very nicely into theoretical concepts.”

“And that has been shown now” as the world was plunged into a “full-blown” financial crisis, he said.

“I think the possibility that the accounting treatment could aggravate the crisis was very real,” he said. Others, including investor advocates and the IASB-FASB Financial Crisis Advisory Group, have said that fair value accounting did not cause the crisis, but helped to reveal problems in the marketplace.

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Volcker: 'Signs Good' for SEC Action on Road Map

On a question on the minds of many in the audience at the event co-sponsored by IASB's parent foundation and the American Institute of Certified Public Accountants, the former Fed chief voiced a hope that the Securities and Exchange Commission would make a decision to accept IFRS for use by U.S. public companies along the lines of the "road map" proposed by the SEC.

"I hope and believe the signs are good in that respect," Volcker said.

SEC officials, including the commission's chief accountant, have suggested that the agency will cast renewed attention on the IFRS road map proposal starting this fall. Under the proposal, the commission has outlined a timetable for a 2011 decision on whether to require use of international standards by U.S. registrants and actual application of the standards by domestic companies possibly starting in 2014.

He said he hopes that the SEC will be influenced by recent comments made by leaders in the Group of 20 after their September summit in Pittsburgh. The leaders recommended a redoubling of efforts by rulemakers to finish a single set of global accounting standards by mid-2011.

"I think it's interesting that the G-20 has put this on the agenda," said the former Fed chief. "Again, it's a question of independence. The SEC may be independent. But they ought to take account of the wisdom of political leaders getting together and recognize that if the G-20 gets together at that level," and suggests enforcement of international standards, "they should not inhibit the process."

"And I think they have acted," Volcker added, referring to the U.S. securities commissioners. He suggested he believes that the "test"—a vote on the IFRS road map—will be coming up shortly. "And I hope that that test will be passed with flying colors," he said.

G-30 Words on Fair Value Accounting

At one point in his speech at the AICPA-IASCF conference, Volcker offered a critical appraisal of fair value accounting contained in a report earlier this year from the Group of 30. He suggested the words represent a crystallization of issues that he subscribes to, he said, adding that he recalls he actually wrote the words. Specifically, he quoted a passage from a January 2009 G-30 report titled *Financial Reform: a Framework for Financial Stability*.

"Fair value accounting principles and standards should be reevaluated with a view toward developing more realistic guidelines for dealing with less-liquid instruments and distressed markets," according to the section of the report cited by Volcker.

"The tension between the business purpose served by regulated financial institutions that intermediate between credit and liquidity risk and the interests of investors and creditors should be resolved by development of principles-based standards that better reflect the business model of these institutions, apply appropriate rigor to valuation and evaluation of intent, and require improved disclosure and transparency," the passage in the report read by Volcker continues.

Different Perspectives of Banking Regulators, SEC

In a related vein, Volcker focused on a time-honored fulcrum of conflict between the Securities and Exchange Commission and the federal banking agencies.

"I speak as one who's been a bank regulator and a central banker. And this argument about accounting standards, and an SEC approach and a banking approach, is not new," he said. "It's going back 20 or 30 years, because the perspectives of the different organizations are different."

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“The central banks are worried about financial stability and continuity. And the SEC is worried about informing investors,” Volcker continued. “And there is a perception” that those two views clash, “and sometimes they do.”

“But I think too much can be made of that,” he said. “And if we've got a sensible approach” in this debate, “as we've been discussing, that old tension between those interested in financial stability” and those interested in transparency “could disappear.”

“I think the [G-30] approach in the midst of crisis is worried about the stability implications,” said Volcker. “And the SEC is going to have to take account of that—it should take account of it.

“That's not a new thought from an old central banker,” he acknowledged.

By Steve Burkholder