

AccountancyAge

Interview: IASB chairman Hans Hoogervorst

by Richard Crump

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POLITICIANS ARE KNOWN for their thick skin, which in the case of Hans Hoogervorst is just as well. Since becoming chairman of the body that sets global accounting and reporting rules, the former Dutch finance minister has had to contend with a barrage of criticisms about its standards and processes.

Hoogervorst became head of the International Accounting Standards Board (IASB) during the financial crisis and has since faced claims – some justified, others not – that the rules by which companies report their figures are “flawed” and that the faults have been exacerbated by the IASB.

The main point of contention is that elements of International Financial Reporting Standards (IFRS) contributed to the financial crisis by increasing volatility in the system and allowing banks to inflate profits and under-provision for liabilities.

Though not responsible for writing the rules, he has become a staunch defender of the standards, while addressing the areas where improvements were clearly needed. Even before taking up the IASB post in July 2011, Hoogervorst says he believed claims that fair value accounting was a main contributor to the financial crisis because it created too many artificial profits were “fishy”.

“Most of the truly problematic assets were measured at amortised cost and not at fair value. Fair value played very little part,” he tells *Financial Director*.

Overall, IFRS performed well during the crisis, Hoogervorst says, and adds it is “silly” to blame the accounting standards for the excessive leverage in the banking system. “Most banks were leveraged to the hilt and our standards showed it,” he explains. “Everybody who looked at the system could have seen it, except they chose not to see it.”

Nor does he hold stock with those who still hanker for the UK GAAP and argue it all would have been very different if the UK had not taken “deeply compromised decisions to adopt faulty standards” – an argument he says is “demonstrably nonsensical”.

“It’s hard to tell where this criticism comes from,” he says. “These people tend to think that IFRS brought all these troubles to the UK and had the UK stuck with UK GAAP, these troubles would not have happened. That is certainly nonsense. The impairment model under UK GAAP was almost exactly the same as under IFRS. Most banks did not change their level of provisioning when they changed from UK GAAP to IFRS.”

Hoogervorst is not just dutifully trotting out the party line. He has not shied away from tackling faults in the incurred loss model used by banks to value their assets and loans under IFRS, nor has he pulled his punches when looking at the processes of his own organisation.

In an IASB board meeting last year, Hoogervorst bemoaned “dysfunctional” processes and decision making that have stymied the pace of the board’s reforms and damaged its credibility to deliver projects on time.

Such candour is indicative of his straight-talking style. “I’m Dutch and I can’t help it,” he quips. “In politics, it helps if you are clear about the problems you are facing and clear about solutions.”

This is not mere rhetoric from Hoogervorst; actions have been taken to improve the IASB’s working processes. For instance, board members are more involved in preparatory work by staff.

"We don't want board members to wait until the board meeting to first express their opinion about a certain standard. We want them to help staff and that is being done more than in the past," he says.

Untangling OCI

Hoogervorst has taken the tough stance so the IASB's project to revise its conceptual framework isn't delayed like some other reforms. The framework underpins the way it develops and rewrites its standards and has been described by the UK reporting watchdog, the FRC, as "critical" for IFRS.

According to Hoogervorst, the project should be treated as the board's "main deliverable" focus over the next three years because the IASB is "struggling with so many basic questions in terms of measurements".

As a result, some proposals have been based on creative interpretations of the existing framework, while others have been based on concepts that are unclear and have not been generally agreed.

"There are a couple of unresolved items like the meaning of other comprehensive income (OCI) and measuring performance," says Hoogervorst. "These are basic questions that will always be there. Right now, there is nothing in the framework for which measurement basis we use in which circumstance. We must give some better theoretical underpinning for that if we are able to disentangle the mystery of OCI that we have made ourselves."

The framework will deal with important issues that underpin the way FDs report company results. For instance, should stewardship be considered when developing accounting standards? Will it be required to recognise all assets and liabilities? Are some better dealt with by disclosure than by numbers in the main financial statements? Will the framework lead to appropriate selection of measurement bases, or will it specify an 'ideal' measurement basis such as fair value? How should performance be defined? What income and expense should be excluded from profit and dealt with in other comprehensive income?

"Having a proper conceptual framework is important for consistency within our standards. We cannot cover every transaction so it's important you have a clear framework," says Hoogervorst.

Another issue that provoked some controversy is the removal of prudence from the framework. In a recent Lords committee hearing, Lord Lawson said the IASB's decision to "abandon the touchstone of prudence and replace with neutrality" – in order to drive forward convergence with the US – "with the wisdom of hindsight at the very least was a stupid thing to do".

Yet, while the Hoogervorst believes the treatment of prudence was "spot on", its removal was defensible in view of the need to underline the importance of neutrality.

"Prudence was often being used for excessive conservatism, for the creation of hidden reserves which can be released in bad times, creating a problem with earnings management," he says. "It sounds conservative to create these reserves, but if they are used to cover up losses in bad times, they are far from prudent."

He nonetheless emphasised that the basic tenets of the concept remain intact and visible throughout the way companies report.

"The meaning of prudence was that we don't want a conservative bias in the standards and they have to be neutral, but if you are quite certain about an uncertain outcome of a measurement, you better err on the cautious side," says Hoogervorst.

"If you look at our standards, we still practice that. When a contract is loss-giving, we require it to be taken immediately. In our new revenue standards, we only allow recognition of revenue when a company is certain. We are now making an impairment standard that is much more forward-looking and requires banks to recognise losses even when they are not yet in default. We are quite prudent."

Trust me – I'm not an accountant

As the leader of the regulator charged with setting global accounting standards, one might expect Hans Hoogervorst to be steeped in technical accounting knowledge. This could not be further from the truth.

The chairman of the IASB is a Dutch former politician, holding positions including minister of finance, minister of health, welfare and sport, and state secretary for social affairs. That is not to say he is without experience of accounting.

Hoogervorst is a former securities regulator and was also responsible for supervising financial reporting while chairman of the executive board of the Netherlands Authority for the Financial Markets.

The benefits he brings outweigh any drawbacks from a lack of technical knowledge. In some ways Hoogervorst's experience is indicative of the way in which the role of an FD has morphed from number cruncher to business partner.

"Obviously, there are challenges for me, it's a highly technical profession and normally you study for at least five years," he says. "At the same time, the fact that I am not an accountant has its advantages. It forces me to focus on the main issues. When you do this job as an auditor, you will be inclined to look at the detail, my added value is the wider scope that I have.

"I already knew when I started that accounting is far from an inexact science. It's not just a matter of number crunching, but I must say that it was a surprise to me that accounting is even more judgemental than I thought it to be. It is not a black-and-white world and the consequence of that is the room for judgement is high; the room for pressure and lobbying is also high. It is more political than I thought it was."

CV

July 2011 - present: chairman, IASB

2007 - 2011: chairman, Netherlands Authority for the Financial Markets

2003 - 2007: minister of health, welfare and sports

2002 - 2003: minister of finance

1998 - 2002: state secretary of social affairs and employment

1994 - 1998: member of parliament, Netherlands

1988 - 1994: policy assistant on finance to the People's Party for Freedom and Democracy

1986 - 1987: policy officer for international monetary affairs, Dutch Finance Ministry

1983 - 1986: international banking officer, National Bank of Washington

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