

COMMENT

Only GAAP terms in prospectuses

'Distributable cash' figures led retirees to invest in weak trusts

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Six weeks after the income trust party ended, I must say I'm somewhat relieved. Somewhat.

Whether the government acted for the right reasons or the wrong reasons, it's better for investors in the end that some air was let out of the trust market. Short-term pain could turn into long-term gain, provided we learn our lessons.

The thrust behind the trust decision in large part boiled down to the issue of tax inequity. The government's reasoning might have been valid, but we will probably never know.

One has to wonder, though, why some trust executives are so upset with having to play by the same rules as everyone else. It's enough to make you think they did possess an unfair tax advantage. Or perhaps, as I have said for many years, the real advantage is in the fuzzy financial reporting that many trusts use to boost their unit prices.

Several trusts are truly nothing more than pyramid schemes, in which highly questionable cash forecasts are used to inflate market prices, and spur continued equity offerings. The government's clampdown effectively stopped additional companies from converting to trusts and engaging in misleading financial reporting.

I know what you're thinking. Why should the good trusts, the ones that weren't misleading investors, have to pay as well? I'll tell you why: because the securities commissions and accounting-standards setters, yet again, weren't doing their jobs. The way I see it, Finance Minister Jim Flaherty took one for the team, and the people using their hands as seat cushions at the securities commissions and accounting standards board should be indebted to him.

Dozens of trusts have been complete busts, costing investors billions. Underwriters and trust executives must rightly

REGULATORS USED THEIR HANDS AS SEAT CUSHIONS

share the blame for these collapses, but the accounting standard-setters and securities commissions should have been keeping an eye on them. Instead, they stood idly by for years.

Essentially, certain trusts and their underwriters used deceptive yields and distributable cash figures to con retirees. What really needs to be addressed by government intervention is the deliberate manipulation of financial terms by corporate agents, and our inept accounting standards-setting process. Good trusts have never needed bogus financial figures to justify their worth, and terms like distributable cash should not be allowed in prospectuses.

Nevertheless, the manipulated figures played a crucial role in bringing many poor trusts to market. Therefore, we still have huge problems on our hands. While no new trusts will mislead investors, none of the issues that allowed investors to be abused in the first place have been fixed.

It's interesting that many pundits are saying that several trusts will now disappear, either by acquisition or going private again. That either has something to do with the elimination of the tax advantage that some claim didn't exist, or because the only way the weakest trusts have survived is by issuing more and more units. This of course, can't continue any more.

Trusts that are living beyond their profitability levels have to attract cash from new unitholders just to survive and continue the pyramid scheme. In short order, people will stop providing the cash and those trust unit prices will collapse.

It's clear that the biggest factor that contributed to investor losses from the trusts is the abuse of distributable-cash reporting. Its overuse in company prospectuses allowed underwriters to parlay the concept into inflated yield figures, which then inappropriately persuaded many retirees to invest, not realizing the absence of income to support the cash payouts.

Neither the accounting-standards setters nor the securities commissions did

anything to regulate the use of distributable-cash figures. But then again, we've heard this story before. Remember the use of unregulated pro-forma financial reporting during the tech boom? The likes of "cash baseline earnings" have gone the way of the dodo. There's no reason the same can't be done for "distributable cash" before more investors fall victim.

The easiest solution is to ban unregulated (non-GAAP) financial figures from prospectuses, whether it is trusts or corporations. They have already been banned from audited financial statements, with good reason.

Take **ACE Aviation Holdings Inc.**'s recent spinoff of **Air Canada** in an IPO (not an income trust) as an example.

The company made thorough use of earnings before interest, taxes, depreciation, amortization and aircraft rental (EBITDAR) in its prospectus, boasting \$938-million in the first nine months of 2006, versus net income of just \$70-million.

EBITDAR is a concept with very limited analytical use. It ignores cash costs such as interest, taxes and aircraft-rental charges. But last time I checked you needed airplanes to fly passengers, and you needed to pay your interest and taxes to stop creditors from taking your planes away.

Air Canada's IPO took off like a wounded bird and only time will tell whether EBITDAR flies with investors. My bet is that people will eventually want to see some cash and income coming through the door. Until the non-GAAP terms are banned from prospectuses, the door is still wide open to a continuing process of financial exploitation.

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