

FP INVESTING

COMMENT

Auditors must be held to account

Should be liable
when they approve
shoddy statements

AL ROSEN

It's a waste of time to talk about the enforcement merits of a national securities commission, unless our federal politicians are also willing to completely revamp the way in which financial reporting standards are set in Canada.

The favourite tool used by Canadian fraud artists to cover up their scams is undoubtedly the audited financial statement. It's like having the police write a letter of recommendation for a charity scam before the culprit goes knocking on doors. People tend to trust the police, and for some reason, they still erroneously believe that a financial statement audit is worth more than the paper it's written on.

I've said this before and I'll say it again: Financial statement audits are worthless to investors. You cannot sue an auditor for approving misleading or fraudulent annual financial statements in Canada. Audits are simply a risk-free revenue stream for the auditing oligopoly, guaranteed by federal legislation, and cemented into place by a Supreme Court of Canada decision that effectively endorses widespread auditor negligence.

That is why a national regulator will not be any more effective at prosecuting financial statement frauds than the sum of the current work of the provincial commissions, which, by the way, is close to nothing.

Sure, the occasional penny-ante crook or insider trading scam is dealt with by the commissions. But, the problem is that the current commissions couldn't care less about prosecuting, or

REGULATORS MISS

95% OF CAPITAL

MARKETS FRAUD

even correcting, misleading financial reporting. It's not that most accounting scams are over the heads of the provincial commissions. Rather, there is, again, this belief that audited statements should not be questioned by securities regulators. As a result, they are missing more than 95% of the action when it comes to capital markets fraud.

The regulators seem incapable of believing that audited statements can be seriously misleading to investors, or that accounting rules have been deliberately weakened by auditors over the years to diminish their liability to investors, and to protect their revenue oligopoly.

Cooking the books is the forgotten fraud of choice when it comes to the minds of our federal politicians. Federal Finance Minister Jim Flaherty recently remarked about the need for a national securities commission in a speech to the Halifax Chamber of Commerce. After lengthy remarks about the benefits of lower costs and greater opportunities, he gave a passing nod to the prospect of improved enforcement.

However, he mentioned nothing of accounting, and seemed mostly focused on money laundering. Nor could he bring himself to mention Nortel, YBM Magnex, Atlas Cold Storage or the deceptive yield calculations used to market dozens of now-failing income trusts. The closest reference was to Enron, which was essentially downplayed as a largely isolated U.S. occurrence.

How is it that Nortel's auditors have never been asked to explain the repeated financial restatements at the company?

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A judicial inequity

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A \$3-billion tentative deal was recently reached with former shareholders of Nortel to settle the dispute. The auditors paid nothing in restitution, but continue to collect fees from the company.

How is it that after nine years, our politicians have not acted to legislatively correct the judicial inequity established when the Supreme Court of Canada decided that auditors could sign misleading financial statements without risk of prosecution?

And how is it that the chairman of the Canadian Accounting Standards Board can say that income trust yields are "baffling," "drivel," and an inappropriate overstatement of return on investment — and yet — neither the auditors, nor the securities commissions are doing anything to correct the problem?

In fact, the only group doing anything is the Canadian Association of Income Funds, but they are funded by none other than your neighbourhood income trusts and their underwriters. Great — no conflict there.

In the United States, such a problem would likely be handled by the SEC, which has the power to set its own accounting rules, and can even supersede the independent U.S. accounting rule-setting board. The notion of an SEC-style regulator setting accounting standards in Canada is ideal. But, I tend to agree with Purdy Crawford, who believes that a national securities commission would be limited to merely providing accounting input to our deeply-conflicted, legislatively protected auditors. In effect, little would change.

That is why it is incumbent on our federal politicians to effect change from the bottom up. Only by taking power away from the auditors to set their own self-serving rules and self-limiting agendas, can investors hope to see some accountability return to accounting in this country.

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■ Al Rosen is a forensic accountant at Accountability Research Corp., an independent equity research firm.