FP INVESTING

COMMENT

SocGen 'rogues' show flaws in accounting rules

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A giant hole was blown in the side of the good ship IFRS last month by "rogues" at Société Générale who scuttled €6.4-billion in trading losses. They weren't traders, and they weren't responsible for losing the money; they simply helped to eliminate the loss from the company's current books. I'm speaking of SocGen's auditors, and the trick they used was just one of many available to them under IFRS.

International Financial Reporting Standards, or IFRS, are the accounting rules followed in the European Union and a few other notable countries. They are being touted by Canada's auditing community as the golden elixir for past accounting woes, and have been slated for implementation here in a just a few years.

IFRS are neither rigorous, nor time-tested, nor widely accepted by much of the world, as claimed by the accounting standards board of Canada.

The board, which is financially controlled by the auditors of Canada, stands squarely behind its masters. The auditors stand to reap a windfall in IFRS changeover fees by foisting the new standards on to Canadian companies. While this is not disputed, the auditors attempt to divert attention away from their good fortune and on to the potential benefits of IFRS.

The purported cause for celebration with IFRS is worldwide financial comparability. However, there is mounting evidence that IFRS is a step backwards for financial comparability.

Not only did SocGen's accountants bury €6.4-billion in losses, they buried the credibility of IFRS. SocGen's auditors invoked the mother of all IFRS loopholes, which allows companies to ignore the already vague rules if management decides results are "so misleading that it would conflict with the objective of financial statements." With a flash, €6.4-billion disappeared from the company's results for 2008 (when the losses actually occurred), and were buried in the company's previous year's results.

I'm not sure how recording a loss in the year in which it occurred is misleading, but nevertheless that's what happens when accounting standards are so vague, and presume pure honesty on the part of company management and auditors. So, could the same thing happen in Canada? Glad you asked.

In April 2002, BCE subsidiary Teleglobe imploded after the parent declined to support its mountain of debt. Teleglobe bondholders subsequently took a beating as the company entered bankruptcy protection. But a funny thing happened on the way to the auditors. Looking back at BCE's books now, one would think that Teleglobe blew up the previous year, because that is when BCE recorded the $7.5-billion loss.

If only investors in SocGen and BCE had the same ability to re-write history, they could have saved millions. Simply put, if you give management and auditors the opportunity to obfuscate, they will take it.

The wording of the loophole used by SocGen is typical of many IFRS guidelines. In fact, Canada used to have a similar exception that allowed companies to deviate from the rules on rare occasions. While we closed that loophole a few years back, we are nevertheless set to reopen it under the guise of IFRS. The loophole can be used to ignore any rule at any time. Its potential to obscure is unlimited.

Accountants claim to have the interests of all groups in mind when they audit statements, yet they are only paid by management. And despite their claims of universal fairness, they have argued successfully to the Supreme Court of Canada that they owe no duty of care to individual investors.

Keep the tale of SocGen's missing billions in mind the next time you hear about the supposed wonders of IFRS, and the purported benefits of relying on the honesty of management and auditors.

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