

Changing the rules of the accounting game

IFRS, the IASB, political interference and fair-valuing financial assets: a primer for investors.

European lawmakers recently asked for International Financial Reporting Standards to be changed so that companies don't have to reflect economic reality in their financial statements. Yes, you read correctly. To hell with the facts, please just give us something (anything) to smile about. Accordingly, two things should be noted about IFRS, the new accounting rules coming to Canada. First, the people who set the rules bend quickly to the will of companies and politicians when the end results become unattractive. Second, the recent rule change in Europe was aimed at curbing the effects of fair-valuing assets, which is a major strike at the very heart of IFRS.

Turning to the details, the rule change allows companies to defer recognizing certain losses when assets are marked to market (which is to say, they are fair-valued based on available market data). Essentially, if the unrealized losses become too large, and the company does not want to take the hit to income, the assets can simply be reclassified (after the fact). Executives merely have to claim they will hold on to the assets and assume that the market for them will recover.

While small forests have been sacrificed to explain the pros and cons of fair-valuing financial assets, there has been little focus on how it impacts the validity of the IFRS movement as a whole, or on the collateral damage to Canada.

It didn't take much pressure to push a major change through the International Accounting Standards Board (IASB). Individual companies, like Canada's own Manulife Financial, started grumbling about how unfair it was that they had to fairly reflect the value of assets after the market plunged.

Then the politicians weighed in with



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staff of the SEC is less than enthusiastic about adopting IFRS, and its future in the U.S. is certainly up in the air.

As for Canada, we are still moving full steam ahead on a new set of accounting rules that are untested, inferior to our current standards, and face major changes moving forward—not only because of their inferior quality, but because the world's politicians can't help but interfere in areas they know nothing about.

their usual expertise. Most vocal on the subject was French President Nicolas Sarkozy, who led the critical charge against the fair value rules. A joint statement made by the European G-8 members in early October stated rather presumptively that "we will ensure that European financial institutions are not disadvantaged vis-à-vis their international competitors in terms of accounting rules... This issue must be resolved by the end of the month." And so it was.

Even though the impact on financial statements is huge, the swift rule change came as no surprise. Two major knocks against IFRS existed even before the recent crisis emerged (and incidentally, they don't bode well for Canada's adoption of the standards). One knock is that IFRS is a mere child in terms of its development. The other is that the IASB structure is wide open to political interference, which is far from ideal when it comes to fostering longer-term stability.

All the developments point in one direction: the powers that be have only just begun to tinker with IFRS. Discussions on further accounting changes continue at global forums like the recent G-20 meeting of finance ministers in Brazil. Companies and lobby groups have urged for the relaxed fair value rules to apply to the likes of CDOs and even bonds that have suffered

market declines.

The general consensus in the U.S. right now is that current SEC chairman and Republican appointee Christopher Cox is trying to ram through the beginnings of IFRS before he gets the boot from the new Democrat administration in January. Our contacts stateside inform us that the



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