



Northland Bank in  
Calgary, 1985

**BETWEEN THE LINES**

## Decades lost

The switch to a new accounting standard for public companies will worsen the lot of Canadian investors

by Al Rosen



**A**s Canada moves toward adopting International Financial Reporting Standards (IFRS) as the accounting standard for public companies, it is preparing to turn its back on decades of progress shoring up financial reporting in this country. Any regular reader of this column will know that Canada's current mix of loose accounting and deficient securities enforcement is wholly unacceptable for investors. The introduction of IFRS in its current form will only make the situation that much worse.

A history lesson helps to illus-

trate the point. Over Labour Day weekend of 1985, two Alberta banks, Northland and Canadian Commercial, were shut down by regulators when it became apparent that they were insolvent and could not be bailed out. The dire situation did not materialize overnight. In fact, executives had known for years that the banks had serious problems. According to the federal inquiry that investigated their collapse, "The various strategies adopted by management had one object in common: to keep up an appearance of healthy financial condition in the bank's statements until better times returned."

Among other accounting chicanery, the banks engaged in reporting uncollectible interest accruals as part of income, and failing to make specific loss provisions for deteriorating loans. "The financial statements became gold fillings covering cavities in the assets and in the earnings of the bank," according to the inquiry. Furthermore, "As the line of sound and prudential banking bent, so did the accounting treatment, until the bank's statements and reality no longer coincided."

The federal inquiry roundly criticized the auditors, and even blamed them for misleading management, directors and regulators as to what constituted proper accounting. A couple of the recommendations to come out of the inquiry were to tighten the accounting rules regarding loan loss provisions and capitalized interest. The inquiry's report specifically warned that accounting judgment "will be abused if there are no standards by which to measure its exercise." The conclusions of the report were so damning that Canada went on to overhaul its accounting rules for the areas that misled investors. In fact, a whole new section was added to the accounting rule book.

The point of all this backstory is to illustrate the significance of not having such measures laid out specifically in financial reporting requirements. The inquiry recommended accounting that consisted of "general guidelines supported by clear prohibitions." And as you might have guessed by now, IFRS is shockingly silent on many of the issues that led to previous financial collapses in this country (not just the Alberta banks).

When Canada adopts IFRS by 2011, gone will be the "clear prohibitions" that the inquiry warned us about more than two decades ago. And accounting for bad loans is

just one area that is deficient under the proposed new standards. Revenue recognition, related-party transactions, variable interest entities, and extraordinary items also receive short shrift under IFRS. And the problems extend beyond just financial institutions; every single company will be affected. In fact, entire industries that are crucial to the Canadian economy are also virtually ignored.

While we can hold out hope for improvement, it is clear that Canada's costly experiences will not go far in shaping future accounting reforms. Our accounting rule-setters admit that if we ask for too much consideration of Canadian-specific needs, the rest of the world might just ignore us altogether.

IFRS will not prevent Canadian companies from acting responsibly

## **IFRS is shockingly silent on many of the issues that led to financial collapses in this country**

when it comes to financial reporting, but it won't require them to be honest, either. Too many holes exist, and establishing a consensus for future reform will only become harder as more countries voice their opinion. Canadian considerations will be diluted to nothing. And while other countries, such as Australia, have national securities regulators to crack down on companies that push the vague rules, we have no such backup plan. Pity the poor Canadian investor come the age of IFRS.

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