

## COMMENT

## Companies win, investors lose

### Accounting standard-setters waive the rules

BY AL AND MARK ROSEN

The Canadian accounting standards board announced last week that they would let companies reclassify certain assets to delay reporting losses to investors.

What happened was exactly what was warned about in these pages two weeks ago. Companies are being given more leeway to manipulate net income. In short, Canadian banks and insurers will report higher income than they otherwise could have in their forthcoming year-end reports.

The impact was not lost on the market, and the reaction to be honest, is somewhat troubling. Canadian bank stocks gained an average 5% on the news when investors learned that more accounting gamesmanship would be allowed.

It pays to have friends (or rather friends that you pay) if you're a public company looking to boost your income and stock price. All that was needed was for a few Canadian companies to put in a call to one of their existing vendors.

You see, corporations hold the power in Canada when it comes to setting accounting rules. Companies pay the auditors and the auditors financially control the accounting standards board. Simply put, money talks.

By the way, Canada is alone in the world when it comes to allowing this massive conflict of interest between accounting rule-setters and money-hungry auditors. The problem, just to be clear, is if you allow companies to influence accounting rules, they will lobby for the loosest rules possible, leaving investors all the more exposed.

In response, the Canadian rule-setters usually argue that they take steps to consider investor interests — steps like exposing accounting changes to a public comment period. Oh wait, that's not happening this time. The usual comment period has been waived in a

rush to implement the weaker rules in time for the banks to prepare their October year-end results.

Moving to Plan B, the accounting standard-setters have defended their move as simply catching up to the rest of the world in changing the accounting rules midgame. Nevertheless, it comes off as a knee-jerk decision, especially when Canadian banks are not crumbling like those stateside and in Europe.

The benefits of rushing through the changes are not readily apparent from an investor perspective. And are investors not the ones most affected by the decision to play fast and loose with reporting net income?

The bottom line is that the accounting rule-setters have a long documented history of not caring about investors. For one, they have argued successfully in the Supreme Court that they owe no duty of care to investors for approving misleading annual reports. And what could say more about their attitude toward investors than their apathetic stance when it comes to granting excessive management leeway in the accounting rules.

While most would consider the latest move to loosen the rules the start of a slippery slope, the accounting standard-setters see it more as a step toward accounting utopia. The accountants argue that any abuse of the leeway granted is actually a corporate governance issue and should not have an impact on setting idealistic rules. Talk about mentally washing your hands of something.

In any event, the end result is clear: Investors have another reason to question the quality of earnings reported by Canadian companies. But this is just the tip of the fair-value iceberg, after all. Wait until IFRS hits with full force.

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