

COMMENT

A bad time to loosen accounting standards

Deregulation like treating a patient with poison

AL ROSEN

How does it happen that the CEO of one of Canada's largest companies decides to focus his ire, in the most tumultuous of markets, on something that most regard as interesting as drying paint?

Last week, Manulife Financial CEO Dominic D'Alessandro launched into a five-minute impromptu "sermon" during the company's investor day, in which he said current accounting rules were "absolutely nuts" and "make no sense for anybody."

Mr. D'Alessandro said he believes that unchecked, the ultimate outcome, among other problems, will be higher insurance costs for everyday Canadians.

He is not alone in believing that accounting rules have contributed, or even caused, the current financial crisis. In fact, the very next day the SEC issued a memorandum to corporate accountants attempting to rein in volatile financial reporting, and the billion-dollar headline losses it was spawning.

Following that, U.S. ac-

counting standard-setters held an emergency meeting to issue new guidance on the subject.

So did accounting cause the current financial mess? The short answer is no. The long answer is that it's a symptom of a larger push toward deregulation that did cause the current crisis, and therefore, it still needs addressing over the longer term in both the United States and Canada.

But let's rewind for a minute. The accounting in question focuses on so-called fair value rules. Recent changes in the United States have required companies to value obscure and arcane financial instruments that are occasionally unique unto themselves. In these instances, and this is to simplify, the predictive power of the models used to value the instruments has been thrown into question because of the massive changes taking place in the market.

On top of that, companies have also had to value less obscure assets, but for which there are currently no liquid markets. Essentially, companies having been marking-to-market assets (and recording losses) for which the latest transactions have been distressed sales, which are arguably not a reflection of fair value for other holders of similar assets.

This has created somewhat

of a tail wagging the dog scenario, and in fact, led to the inclusion of Sections 132 and 133 in the Emergency Economic Stabilization Act passed in the United States last week. Those sections allow the SEC to suspend fair value accounting for any issuer or transaction it deems necessary, and requires them to investigate the impact of the rules, in concert with the Fed and Treasury, and report back to Congress in 90 days. Interesting times for accounting indeed.

However, the issue at its core goes far beyond the current financial mess. In fact, like many aspects of the crisis these days, the solution could end up exacerbating the problem over the longer term. Should the SEC and FASB relax the fair value rules, they will essentially do it by injecting more management leeway into the process.

That same push for greater management wiggle-room is the theme that lies at the heart of the move towards International Financial Reporting Standards. Indeed, the notion of fair value accounting is set to expand greatly with the introduction of International Financial Reporting Standard (IFRS) in Canada. If you thought marking-to-market financial assets caused confusion, wait until the value of inventories, real estate, capital assets and more are also



WIN MCNAMEE / GETTY IMAGES FILE PHOTO

U.S. President George W. Bush, flanked by Federal Reserve chairman Ben Bernanke, U.S. Treasury secretary Henry Paulson and SEC chairman Christopher Cox, speaks about a plan by the federal government to try and shore up failing financial markets Sept. 19. Although Cox is a Republican appointee, John McCain has already called for his head.

jiggered at the end of every reporting period.

However, we should not forget the actual issues that led to the current financial crisis, including massive deregulation in many areas. Much of the criticism for that deregulation, including the lifting of reserve requirements and the voluntary supervisory program of the now failed investment banks, is being placed at the feet of the SEC, and its current chairman Chris Cox.

Thus, even though Mr. Cox is a Republican appointee, GOP presidential hopeful John McCain has already called for his head. And in an ironic twist, it was Mr. Cox who has generally been regarded as leading the push towards the potential U.S. adoption of IFRS, which is the accounting version of deregulation squared.

Thus, suspending or modi-

fying the fair value rules at this point is akin to treating the symptoms of a disease with the poison that caused it. While mark-to-market losses make the situation look worse than it is, there are plenty of real economic losses that were caused by greedy bankers, faulty risk protections, and consumer spending gone wild.

In the end, the accounting is not the cause of the crisis, but it still needs considerable fixing, because it is also the product of a deregulated environment that is the real cause of such great pain for investors.

Financial Post

Al Rosen is a forensic accountant at Accountability Research Corp., an independent firm serving Canada's largest institutional investors. www.accountabilityresearch.com