



Federal Reserve chairman Ben Bernanke, Treasury Secretary Timothy Geithner and SEC chairman Mary Schapiro in Washington, D.C.

BETWEEN THE LINES

Reform or perish

While the United States constantly rebuilds its regulatory framework, Canada is stuck in a destructive time warp.

by Al Rosen



It's not really fair to say that Canada is standing still when it comes to the recent wave of financial re-regulation that is sweeping the globe. But that's only because we never bothered regulating in the first place.

Let's face it, Canada is stuck in a time warp. While U.S. Treasury Secretary Timothy Geithner recently unveiled a sweeping six-part plan to regulate everything from derivatives and hedge funds to capital reserves and systemic risk, Canada only just now wrangled a conviction in the decade-old, slam-dunk fraud case known as Livent.

Ever since the stock market crash of 1929, the U.S. has been building and rebuilding its regulatory framework. Canada, meanwhile, has never even made the leap to tackle enforcement and regulation at the national level. The drawbacks of lacking such oversight are many, but take our country's approach to accounting regulation as just one example.

In the U.S., ultimate say over accounting standards (the rules that govern the very language of financial statements), lies with the Securities and Exchange Commission (SEC), a national body charged with protecting investor interests.

In Canada, we have let the process of accounting oversight become financially controlled by auditors, whose interests tend to conflict directly with investors much of the time.

Naturally, the two national systems come to different conclusions concerning certain changes to accounting rules. In Canada, we are hurtling quickly toward the adoption of International Financial Reporting Standards (IFRS). Our auditors will enjoy a windfall of fee income from switching client companies to the new rules, and will also enjoy an added level of legal protection if they perform substandard audits. Investors, on the other hand, will pay a hefty price in terms of weaker financial reporting.

By contrast, SEC chairman Mary Schapiro warned that adopting IFRS in its current form could trigger "a race to the bottom." While Canada's auditors decided to assume the new standards with little if any public debate, U.S. legislators have denounced everything from the high costs of IFRS implementation to the lack of independence in the board that sets the rules. And that's even before considering the rules' lack of substance—which is the very heart of the issue.

It is fairly clear to even a casual observer that IFRS is a far cry from current North American accounting standards. While the former hasn't even been in existence for five years, and continues to change dramatically, our current standards have been developed over five decades and have closed off many of the loopholes that have misled investors in the past. In essence, IFRS backtracks on many of the prohibitions in current Canadian accounting, and is shockingly silent on key issues to our economy, like accounting for resource industries.

The real tragedy of the new standards, however, will not become apparent until we see the results of them in action. Unfortunately, the supposed keystone of IFRS will actually prove to be its fatal flaw. IFRS has been left deliberately wide open in many areas, and is supposed to rely on practitioner judgment to guide the process. However, the new standards have been rushed into Canada in such a needless hurry that very few accountants and auditors will be adequately trained upon implementation. The likely result, for lack of a better expression, is an accounting free-for-all.

To be frank, auditors and accountants are simply following the money. While one might expect a higher public standard to be set by one of our professional self-

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regulatory organizations, the accountants have a long history of ignoring investor needs. Our legislators have done nothing for more than a decade as accounting standards have sunk to new depths and public company audits have become worthless to investors.

So, let's not make the mistake of assuming we have nothing to fix on the financial regulation front because we had such a strong system going into the meltdown. The truth is, we never bothered to build much substance in the first place—and that's nothing to be proud of.

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