


BANKING CRISIS OR ACCOUNTING CRISIS?

By Francis X. Ryan, CPA



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You would think it would be intuitively obvious to most observers that securities prices should be set at current market values.

Or is it not that obvious?

I have become increasingly frustrated in recent years that financial information prepared and presented in strict accordance with the guidance detailed in the contemporary accounting literature can be so at odds with the economic reality it is supposed to represent.

CPAs are responsible to the public, and this responsibility transcends all others. AICPA's Code of Professional Ethics states, "Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism." This does not mean CPAs cannot also be responsible to an employer, an associate, or a supplier, but it is the public that is the primary concern. CPAs are also responsible for being objective. Many perceive a CPA's overriding responsibility to be conservative, however, it is objectivity that undergirds virtually everything that we do and every decision we make. We are advised, "Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest."

The information that flows from a strict interpretation of FASB's recent fair value pronouncements does not seem to follow through on those principles. It seems these pronouncements can lead to "conservative" valuations that are far from fair. The question then becomes, do we CPAs have a professional responsibility to ensure the public is aware of this? And if we

believe information as presented could be subject to misinterpretation, do we have an ethical responsibility to draw attention to this potential for misuse?

For example, in the late 1990s, many financial analysts were gleefully proclaiming we were in a new economy and that earnings did not matter. CPAs knew that corporate losses consumed cash; therefore, earnings must have mattered. At the time, I often questioned whether CPAs should have spoken louder when the "new economy" comments were being made. Had we been more vocal, could the tech stocks debacle have been dampened?

Not too long ago, real estate prices in many regions were galloping along at growth rates of 20 percent or more. Hybrid and negative amortizing mortgages were becoming fashionable. Most CPAs who I spoke with expressed serious concerns about the wisdom of such mortgages and the sustainability of such gains. Should the CPA profession have spoken more loudly?

In some ways, the volatility of bank stock prices over the past few months and the recent government intervention on behalf of financial institutions are a direct result of accounting conventions. Specifically, I am referring to recent fair-value pronouncements that relate to the timing of recognizing impairment charges. Under current GAAP, relatively short-term asset market price depressions are leading to the recognition of impairment charges that may not be reversed when conditions improve. This is caus-

ing banks to write off assets in record amounts, perhaps unnecessarily. Attempts by Congress, the SEC and other governing bodies to mitigate the damage by relaxing those rules are taking place only after the damage has been done.

The very-short-run, short-run, and long-run planning horizons are extremely important for valuation issues. An asset temporarily impaired in the very short run due to market instability may be valued more realistically in a few weeks or months. To require a bank - or any firm - to write down assets in light of recent market turbulence seems to run counter to the public trust CPAs strive so hard to uphold.

Would anyone reasonably believe that the largest shareholders of many banks would be willing to sell their stakes for the prices listed today?

While some may sell to avoid exposure to such turbulence, could the bank itself be sold for its imputed post-impairment value? Not likely. Yet, a CPA performing an audit, or a CFO, would be committing career suicide by deviating from “published” very-short-run market valuations. Imagine what an SEC counsel for a firm would tell his or her client if you refused to write down an asset temporarily impaired to current market values. “No one goes to jail for being too conservative” would likely be the response. Even with the relaxed rules, only time will tell if CFOs were being too aggressive with relaxed mark-to-market rules.

Pricing in the markets is difficult under the best of circumstances. CPAs should not be put

in a position of valuing stocks, but we should, I believe, accept our responsibility to prevent financial reports from being misused, egregiously or inadvertently. To assume only the “worst case” in valuation assessments is a violation of our principles of objectivity and an impairment of our responsibility to the public. Shareholders who sell believing an asset to be “worthless” have, in fact, been harmed by accounting conventions.

The solution is straightforward: CPAs must fight to revise accounting practices that lead to short-sighted asset valuations during periods of market turbulence, such as we have today. We must be willing to defend valuations that we professionally believe to be impaired only temporarily, despite current market prices. We must strive to act objectively, and we must remember our responsibility to the public.

The CPA profession and government oversight bodies must acknowledge that temporarily unmarketable assets are still assets with value, and that the values framed under the current authoritative guidance, and relied upon as sacrosanct by the public, may be different than their economic values. Disclosure is best for assets that are only temporarily impaired in management’s professional judgment.

Financial statement accuracy is about professional judgment and professional skepticism. CPAs are paid to uphold these values, to be objective, and to remember our responsibility to the public. ● ● ●

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