Fair-value treatment gets 'unfair' scrutiny

White Collar
Enoch Yiu

Have controversial fair-value accounting methods contributed to the global financial crisis?

The answer to this billion-dollar question may be in a 259-page report the US Securities and Exchange Commission submitted recently to Congress.

Some critics say new accounting treatments introduced in recent years that require companies to book assets and investments marked to market value have indeed played a role in the crisis. Some market commentators believe the rule has at least worsened the problem. The theory is fair-value accounting has led firms to book paper losses from the slide in asset values. They then find it hard to raise funds, resulting in a credit crunch.

"The report manages to raise more questions than it does answers," said GaveKal, an independent research firm, in a report issued last weekend.

"The upside to the SEC's findings is that at least we do not have to worry about job losses in the accountancy profession … Indeed, perhaps we should try to train a few car workers on the mysteries of bean-counting in the modern age because, looking at the SEC report, doing a company's accounts looks set to become increasingly manpower-intensive."

GaveKal noted the report only recommends that companies do not mark to market certain assets deemed to have been made "inactive" by their distressed condition. This adds complexity to the rules, as investors need to read a lot of fine print to find out what conditions apply to inactive assets.

The extra good news here for accountants is that they charge for professional hours and will need to work longer to identify which assets should be classified as inactive.

In addition, as the GaveKal report says, the SEC exempts only inactive assets from the mark-to-market rule, not active ones, meaning it has not addressed concerns that when stock and property prices soar, the rule may play a role in inflating firms' assets to create market bubbles.

Accountants think differently.

Hong Kong Institute of Certified Public Accountants president Paul Winkelmann considers it unfair to blame the fair-value accounting treatment for the deepening financial crisis. He said a recent international accountancy conference confirmed there was no link between the rule and the crisis.

"The accounting rules only reflect the fair value of the assets. This is to add transparency to the market. The accounting rule has nothing to do with over-lending, bad debts, off-balance-sheet items or fat bonuses," Mr Winkelmann said.

Crisis and corporate governance

For this week's podcast and video programme, we have invited Patrick Rozario, the head of Grant Thornton's Business Risk Services division, to be our guest.

Mr Rozario has worked for more than 20 years for international accounting firms and the commercial sector. Before Grant Thornton, he worked for other major accounting firms in the area of risk consulting.

He is an expert in internal controls, corporate governance, the Sarbanes-Oxley Act and information technology risk for a wide range of industries in Hong Kong and on the mainland.

In our podcast, he will review how the financial crisis will affect the city's corporate governance standards.

enoch.yiu@scmp.com

Watch the Video Log on to www.scmp.com/video to see Patrick Rozario talk about the impact of the financial crisis on corporate governance in Hong Kong