**THE LYING CULTURE**

***Anthony H. Catanach Jr. and J. Edward Ketz***

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From time to time, it is good to stop and assess one’s progress in life. Such an evaluation helps people to figure out how they are doing and to make strategic decisions to take advantage of upcoming opportunities and to meet future challenges. When we do this for the accounting profession, we shake our heads because accounting shenanigans remain abundant and the seeds for further scandals are sown, watered, and fertilized.

The kernel of this problem is simple: company managers and their advisers are liars. Ok, not all of them, but so many are liars that the business community is in danger of falling on its own petard. Maybe this is because American society has a problem with the truth, as exemplified by our political, military, bureaucratic, sports, and entertainment leaders. We often hear the mantra, “the truth shall make you free,” but our leaders apparently desire to enslave others through their destructively self-serving, lying behaviors.

One obvious current example is the toxic assets still held by banks in the wake of the financial crisis of 2008. These investments have real values lower than their carrying values, but banks refuse to write them down, citing mush about earnings volatility and the adverse effects of mark-to-market accounting. They reject fair value accounting because it would reveal the precarious position of the banking industry. In short, banks are lying about asset values and really are not well capitalized.

Government leaders buttress the banks’ accounting, either because they have been duped, or because they also have incentives to squelch the truth. In fact, the toxic assets held by the Federal Reserve pose an even larger problem. If these assets were properly accounted for, the losses would be astronomical. But, on January 6th of this year, the Fed changed its own accounting rules to prevent losses from going against capital. It’s nice to be able to change the rules when the results are disturbing, but anybody who thinks it changes reality is insane.

Another façade is accounting for repos. This reporting is like eating mystery meat; it may taste good, but it isn’t healthy. Repos are secured borrowings and any alternative treatment is ridiculous. This is nothing new. We learned this over 25 years ago in the savings and loan crisis, yet bankers (aided by their auditor accomplices) continue to pretend that they are relinquishing control of these assets, and employ gain accounting instead. The FASB and the SEC are craven enough to permit these lies.

For more than 30 years lease accounting has been a poster child for lying in financial statements, as so many leases are accounted for as operating leases despite the lessee’s control over the leased resource. If the FASB eliminates most operating leases, as its recent exposure draft suggests, then we shall rejoice over this truth-telling exercise. But, pray tell, why did it take so long?

Pension accounting remains a delightful exercise in wishful thinking despite its recent reforms. That business enterprises are allowed to use projected returns instead of actual returns to compute pension expense is amazing. It also is astonishing that auditors have blessed these projected returns that have soared into the stratosphere—unless these are nominal returns in a world of double-digit inflation.

Yet, governmental pension accounting is far worse. The GASB hasn’t the intelligence, the guts, or the integrity to demand that local and state governments report pension obligations on their balance sheets, as do their business counterparts, since these pension obligations really are liabilities. This is a time bomb that will soon detonate and lead to conflicts between the young and the elderly and confrontations between government and private-sector workers.

And of course, we wonder about the role of the Big Four accounting firms in today’s business world. They are no longer “keepers of the holy grail” as in days gone by. In fact, they are no better than “snake oil peddlers,” trying to pass off an audit, for something quite less useful. The financial crisis of 2008 provides clear evidence of that as they rendered “clean” opinions on overstated bank balance sheets and fictitious “earnings” statements. Most auditing texts declare that auditors must be totally objective, unbiased, and skeptical. Yet, the Big Four continue to resist any attempts to separate them from their “clients,” maintaining that they can be independent even when their client hires and pays them. That this isn’t true is evidenced by the existence of the PCAOB, which acts as the auditor’s auditor.

Similarly, the government lies about Social Security. Presidents, legislators, and administrators tell the story about how they have saved up the excess funds paid by taxpayers into the social security system, but it isn’t true. Politicians from both parties have stolen the money, so now there are no resources in the trust fund. None. And the IOUs that reside there are totally worthless.

We recently heard that the budget deficit is around $14 trillion. This too is a lie because it omits off-balance sheet items, just as companies omit these items. If one tallied the unfunded Medicare, Medicaid, and pension obligations of Uncle Sam, then the real deficit is closer to $72 trillion. We indeed are heading for national bankruptcy if we don’t solve these economic problems. But how can we solve them if we don’t even admit their existence?

Public officials exaggerate when they propose new legislation. We can’t remember the last time we heard a government proposal that overestimated costs. For example, whether you favor or oppose this ObamaCare program, the one thing we know is that its costs are greatly underestimated. We wish our legislators and those in the executive office would attempt to measure these things more precisely.

While education might offer a partial solution, unfortunately educators aren’t helping. They introduce honor codes and the like, but it is only for public consumption; otherwise, we would have more schools policing honor code violations rather than turning their heads. And let’s not forget the rush to include ethics education in the classroom and in professional certification requirements. Perhaps well intentioned, most are simply revenue generating ploys by organizations to make a “fast buck” by offering new courses that have little or no impact on behavior.

We might suggest more enforcement of the rules as a possible course of action, but the executive branch apparently has abandoned this approach so they don’t have to arrest their business world buddies. How else can you interpret the SEC’s closing the investigation against GE in which it overstated earnings by over $1 billion by manipulating its derivatives’ accounting? In that case the SEC did not fine or censure anybody though at least a dozen people could have been cited for crimes against the investment community. Instead, the SEC fined the shareholders $50 million.

This 2009 case is even more interesting given that President Obama named GE’s CEO Jeff Immelt to chair his Council on Jobs and Competiveness. Surely, Jeff is talented enough to head up this task force, but has he the integrity? If we were sure that he had not been involved in GE’s derivatives’ fraud, we would feel better about this appointment.

Finally, this exposition would not be complete without unmasking one final lie: the apology. Haven’t we tired of hearing the standard apologetic lie: “It was not my intention to deceive…I’m sorry.” Why even bother with the attempt? Or the non-apologetic apology: “If I offended anybody….” Such a statement attempts to shift the blame from the guilty party to the victims because they were so sensitive!

We suppose this essay will be dismissed by many company managers, and virtually all Big Four partners, as mere drivel by grumpy old accounting professors who have little to do and who just don’t understand today’s business environment. We admit that we are grumpy old accountants. That’s why we adopt that name for our column; nevertheless, the issues we have raised are not poppycock, but the very reasons we are grumpy, and they should not be dismissed. Not if people desire real solutions to the fundamental problems found in today’s financial reports.

We long for some spark to induce business managers and their advisers to be more honest. Some hoped that Sarbanes-Oxley reforms might help, but the lies continue. We don’t know the source of this new shock, but it will probably be some truly catastrophic market failure whose impact dwarfs the recent financial crisis. Until then we urge investors to apply great caution when undertaking financial statement analysis. Even better, maybe they should abandon debt and equity investments entirely, until corporate managers and their accounting advisors and auditors practice ethical financial reporting and provide meaningful disclosure, two factors critical to investors’ making informed decisions.

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*