Wall Street celebrates accounting rule changes designed to hide losses

Andre Damon
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The Financial Accounting Standards Board (FASB) voted Thursday to let US banks set their own prices for assets in earnings reports, regardless of current prices.

The move, which was heavily lobbied for by Wall Street, is expected to increase bank earnings by 20 percent in the next quarter. Richard Dietrich, an accounting professor at Ohio State University, told *Bloomberg News* that the decision would allow Citigroup to reduce its reported losses by 50 to 70 percent.

The announcement sparked a rally on the stock market, led by financial companies. Citigroup stock rose 8.6 percent, Bank of America soared 9.6 percent and Wells Fargo rose 10.5 percent. The rally subsided later in the day, but financial stocks retained significant gains and the Dow Jones Industrial Average closed with a gain of more than 216 points.

Banks are currently required to calculate their earnings, under so-called "mark to market" accounting rules, according to the current market value of the securities they hold, but the new measure would allow them to value assets using their own internal models where the assets would otherwise be sold into a "distressed" market. Banks have argued that markets are not pricing financial assets fairly, causing credit to dry up and exacerbating the crisis.

This is, in fact, an argument for allowing them to conceal their losses and cook their financial books. It stands in flagrant contradiction to the financial elite's supposed commitment to "free market" principles. Such principles are, in practice, raised when expedient—to justify corporate downsizing and wage-cutting, for example—and discarded when they undermine profits.

Most companies will be allowed to make the accounting changes in the second quarter, but some will be allowed to apply them this quarter. A number of companies had pushed for the new rules to be applied retroactively, but FASB did not go that far.

The move drew criticism from accountants and some industry groups, which said that it would only impede the functioning of the financial system by allowing banks to distort their balance sheets. Others criticized FASB for overtly bowing to pressure from the banks and Congress, which has been pressing for the change as the banking crisis has deepened.

The CFA Institute, a professional organization of financial analysts, denounced the proposal as a capitulation to the financial industry. It warned, "Continuing on the path of politicized accounting standard-setting that caters to special interests" will make it more difficult for FASB "to maintain its credibility."

The Investors Working Group, which is led by two former chairmen of the Securities Exchange Commission, also condemned the decision as too favorable to the banks. Its carefully worded statement read: "In order to create high-quality accounting standards, it is critical that the process be independent..." so as to "ensure that such standards are neutral and faithfully represent economic reality. To the extent that these new FASB proposals reduce the free flow of transparent and reliable financial information, they undermine investor interests and weaken their ability to make sound investment decisions."

The move followed a congressional hearing at which Robert H. Herz, chairman of FASB, was told that if he did not change the accounting rules, Congress would push through legislation to force the FASB to do so.

Only the day before the hearing, Herz gave an interview in which he spoke against changes similar to those just approved, deriding them as "mark to management" accounting.

After the congressional hearing, FASB published a set of proposed changes and invited comments from accounting experts. While the procedure for making proposals and reviewing comments is usually extensive, this time it took only 15 days, with FASB taking only one day to review the responses, the *New York Times* reported.

According to the proponents of the measure, the crisis is to be resolved by "fairly" valuing the securities held by banks, allowing the financial system to return to normality. By allowing the banks to claim their assets as fundamentally sound, they argue, the panic will subside, banks will start lending, and the economy will gradually recover.

But, as Nobel Prize-winning economist Paul Krugman and others have pointed out, the financial crisis is not one of illiquidity, but insolvency, in which banks hold trillions in worthless assets and can't cover their debts.

Under these conditions, FASB's move amounts to another shameless windfall for the banks.

The present crisis was precipitated by the collapse of a speculative bubble, fueled by massive bank leveraging and based on vastly inflated housing values, built up through the medium of securitized loans and other complex financial instruments. As Krugman points out, "Banks and other highly leveraged institutions collectively made a huge bet that the normal rules for house prices and sustainable levels of consumer debt no longer applied; they were wrong."

Now, the banks are to be allowed to use the same obscure and discredited financial models to inflate their balance sheets, based on the claim that markets have ceased to "fairly" reflect the real value of their illiquid assets. This is little more than an excuse to line the pockets of CEOs, hedge fund managers and big investors.

This is a continuation of all the measures taken by the Obama administration in response to the financial crisis. All have as their central aim protecting the wealth of the financial elite.

Even before Obama took office, he lobbied publicly for the Bush administration's bank bailout, including pressing Congress while he was president-elect to authorize payment of the second half of the $700 billion Troubled Asset Relief Program. Earlier this month, the Federal Reserve announced that it would create hundreds of billions of dollars to unfreeze credit markets, in part through its purchase of $300 billion in long-term Treasury notes.

Last week Treasury Secretary Geithner announced a scheme to enable the banks to offload their "toxic" assets by subsidizing hedge funds and private equity firms to purchase them at inflated prices, using hundreds of billions of taxpayer money to cover any losses and insure double-digit profits for the speculators.

He then testified before Congress and stated that the government would not seek to close down the so-called "shadow banking system," which is based on highly speculative instruments, such as credit default swaps, which have played a central role in the collapse of major firms, including the insurance giant AIG.

Now, with the blessing of the administration and the Democratic-controlled Congress, the government is effectively sanctioning accounting fraud. This underscores that the financial elite, working through its political instrument, the Obama administration, is creating the conditions for a vast expansion of the socially destructive forms of financial parasitism that led the US and world economy into the deepest crisis since the 1930s.