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CATO INSTITUTE - Making Financial Statements Mysterious

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SUMMARY: FINANCIAL MARKET REGULATION FAILURE

At the time the attached document was written (August 19, 2008), the author - T. J. Rodgers - was the founder, president and CEO of Cypress Semiconductor, where he also served on the board.

The country was, at that time, in the midst of the worst liquidity crises since the Great Depression, and equity markets were, and to a significant extent remain, unstable.

Rodgers argues that the 2002 Sarbanes Oxley Act and resulting regulations issued by FASB made financial statements of US public companies "indecipherable" and materially misleading (my term, not his). This document makes what could be a dry, academic argument briefly and amusingly. (I suppose that even for CEOs, spouses are the CFOs of many of their households.)

Sarbanes Oxley was not the first enactment that materially distorted many corporate financial statements. SEC's 1992 Staff Accounting Bulletin 92 - imposing ridiculous accrual requirements for loss contingencies under FAS5 that, in some cases, allowed asset purchasers to buy material corporate assets with the seller's money (because the seller could give away impaired assets in exchange for an indemnity from the buyer for contingent liabilities and then reverse a grossly overstated reserve) was an overreaction to the problem of legacy environmental liabilities, then the "flavor of the month."

Reaction to the financial crises has led to adoption of numerous additional reporting requirements. It is unlikely that most (or any) of these are likely to greater financial transparency, particularly given the effects of Sarbanes Oxley, SAB 92 and a host of other enactments.

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