Economic Outlook: Accounting goes to court

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New York State is moments away from pouncing on Lehman Brothers' accounting firm Ernest & Young, putting bookkeepers at center stage of the bank's collapse.

Attorney General Andrew Cuomo, while packing up his office to move over the governor's post, is likely to file suit against Ernst & Young Tuesday, The New York Times reported. The official search for a Lehman Brothers scapegoat, some may say, is here at last.

Absent these past two years, the Times noted, are headlines that declare a chairman of a major bank heading off to jail or being sued by regulators for misdeeds that lead to the financial crisis – not a victimless crime, but the exact opposite. An additional 8 million or so unemployed points to plenty of victims, but no crimes, apparently, into which the vengeful can sink their teeth.

President Barack Obama lashed out at Wall Street out in the darkest days of the financial crisis, describing the hapless banking crowd as "fat cats" who didn't have a clue. Where then, it might be asked, are the squad cars and the handcuffs. For all the emotional baggage funneled through the president's office, where are the bad guys?

Two hedge fund traders at Bear Stearns, which collapsed first, were acquitted of charges of misleading investors, and certainly carrying pitchforks and torches through the financial district would first highlight the candid realization that most bankers honestly chose not to believe or did not know a real estate bubble was about to take the floor out from under them.

New York, however, is poised to accuse Ernst & Young of going along with Lehman Brother's habit of removing $50 billion of debt from the books the day before financial statements were released and handily putting them back on the books the day after.

For some the bookkeeping dodge is an accepted accounting practice; after all, the financial statements are accurate on the day of their release, some analysts say.

Huh?

The practice has, in fact, a trade name attached to it, Repo 105. Finding the origins of the term would be a worthwhile project, but suffice it to say accountants do not say in meetings before presentations with clients, "Hey, let's just solve their problem by committing this really blatant fraud." Instead, they say, "Hmm, perhaps a Repo 105 maneuver would work in this case."

In a series of opinion pieces, John Coffee Jr., professor of law at Columbia University argues, "Strong public enforcement is the best answer," to keeping accounting firms in line.

Lynn Stout, professor of corporate and securities law at the University of California, Los Angeles said, "auditor misconduct may indeed be normal." After all, she argues, auditors are not likely to challenge multi-million clients very often.

"Business often doesn't want its accountants to portray the truth," echoed an opinion piece penned by financial expert Bethany McLean, a contributing editor at Vanity Fair.

Chairman emeritus of the Cato Institute William Niskanen argued that accounting is too complex to be regulated, anyway. Each stock exchange should adopt its own accounting rules, so investors can make apples-to-apples comparisons, he said.

After all, "Current financial accounting is often not a very good guide for either corporate managers or investors," he wrote.

In international markets Tuesday, the Nikkei 225 index in Japan added 1.51 percent, while the Shanghai composite index gained 1.79 percent. The Hang Seng index in Hong Kong rose 1.57 percent, while the Sensex in India gained 0.86 percent.

In Australia, the S&P/ASX 200 added 0.74 percent.

Stock also rose in Europe. The FTSE 100 index in Britain gained 0.99 percent in midday trading, while the DAX 30 in Germany rose 0.94 percent. The CAC 40 in France added 1.11 percent, while the Stoxx Europe 600 tacked on 0.83 percent.