

Now G.M. Has Woes on Audits

By [FLOYD NORRIS](#)

There was a time when [General Motors](#) was seen as the paragon of financial quality. Its bonds were rated triple A, and it was known for the most conservative accounting. Let other companies use liberal accounting rules to make results look better; G.M. did not need such things.

The announcement late Thursday that General Motors would revise profit figures for every year of this decade, and would have to restate the 2005 earnings it had already reported, shows how far the icon has fallen. Less than a year after it lost its investment-grade bond rating, its bonds are viewed as middling even among junk bonds.

"You have to question what controls are in place," said Charles W. Mulford, an accounting professor at Georgia Tech. "When companies like G.M. are profitable, there is not a need to engage in aggressive accounting. What we are seeing now is a pattern of very aggressive accounting that took them well beyond the limits of generally accepted accounting principles."

The restatements indicate that G.M. used some highly questionable accounting techniques in 2000, when it seemed to be flying high, and a year later when profits fell sharply.

Yesterday, G.M.'s stock and bonds fell sharply, but ended above recent lows. Moody's Investors Service also warned that it might again cut G.M.'s bond rating.

General Motors, meanwhile, was busy on another front. Negotiators for the company, the United Automobile Workers union and [Delphi](#) planned to work into the weekend in talks on buyout packages for thousands of U.A.W. members at Delphi. Union officials, who spoke on condition of anonymity, said a deal could be reached in the next few days. But it would be only a part of a bigger agreement involving the companies and the union.

G.M. spun off Delphi in 1999, but has responsibility for retirement benefits for former Delphi workers. In its announcement Thursday, G.M., which originally said that its Delphi liability could be zero to \$11 billion, revised that to \$5.5 billion to \$12 billion.

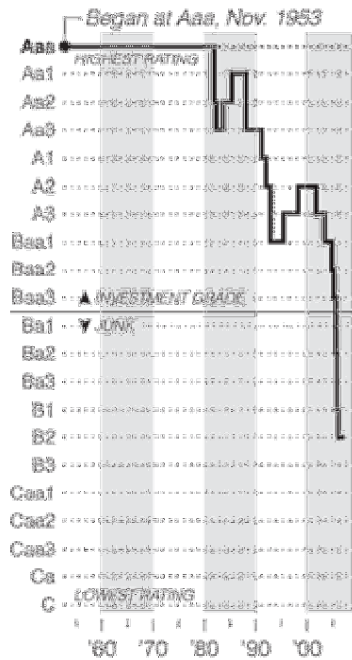
G.M.'s record of financial excellence began long ago. It provided investors with audited financial statements long before it was required in the 1930's. In 1953, when [Moody's](#) and Standard & Poor's first rated the company, it received the coveted triple-A rating, conveying that it was the best possible credit.

The company's financial reputation began to fray 25 years ago. It lost its triple-A rating in 1981 and the next year liberalized some accounting practices. The new policies matched practices of some competitors, but the change heralded other moves. The company soon became a constant presence at hearings of the Financial Accounting Standards Board, arguing for weaker accounting standards.

At one hearing, G.M. told the accounting rule makers that it should not be required to follow revised pension accounting rules because they conflicted with its union contract. The rule makers were unimpressed. Today, G.M.'s generous pension policies are one reason it is in trouble.

From Aaa to Junk

G.M.'s bond rating fell below investment grade in August, was further reduced in November and February, and may be cut again.



Source: Moody's

In 1984 and 1986, when it made two major acquisitions, buying [Electronic Data Systems](#) and Hughes Aircraft, it used tracking stock, which it invented. Those shares were supposed to trade based on profits of the acquired subsidiaries. Abraham Briloff, an accounting professor at Baruch College, complained that G.M. was overstating those profits because they ignored good will charges, but G.M. made no changes.

Then in 1987, G.M. decided that it had been too conservative in evaluating the useful lives of many of its assets. By stretching out the depreciation of the assets, it increased pretax profits that year by more than \$1 billion. But a few years later, it had to write down the value of many assets.

The latest announcement, coming just when G.M. had planned to file its annual report, seemed to indicate that the company may have been in an argument with its auditors from Deloitte & Touche. It cited consultations with Deloitte as a reason for one change. A Deloitte spokeswoman declined to comment.

Some of the changes may also have reflected changes at the top of the company. In December, G.M. announced that John M. Devine, who had been chief financial officer since 2001, would step aside and be succeeded in January by Frederick Henderson, who had been running the company's European operations. That move came weeks after the company said it had uncovered accounting errors that would be detailed in the annual report.

While the changes will raise its stated loss for 2005 by \$2 billion, those additional losses do not affect cash flow and attracted less attention than the issue that was new, and that the company said had delayed the filing of its

annual report.

The new issue concerned the cash flows from its mortgage subsidiary. The cash flow accounting for such things is not new, or controversial. When a company makes a loan, or has it repaid, the cash flow belongs in investing activities. Interest payments go into operating cash flow. But G.M. said that some cash flows that should have been classified as investing showed up as operating.

"The question is, What causes this fundamental type of miscalculation to occur," said Gary J. Previts, an accounting professor at Case Western Reserve University. "It seems pretty clear." But he said that despite the series of restatements, "I think they are still a quality shop" when it comes to accounting.

Other changes G.M. is making, some of which it had previously disclosed without giving exact numbers, indicate that it took advantage of hundreds of millions of dollars of supplier discounts it had not yet earned in 2000 and 2001, and also failed to record a \$55 million expense in 2001, instead treating it as a reduction in shareholders' equity.

Mr. Mulford of Georgia Tech had previously criticized that accounting, and G.M. had defended it. But now it plans to change it.

Another change that G.M. disclosed also made its previous accounting seem questionable. In 2000 it recorded a \$27 million gain when it sold precious metals that had been in its inventory. But it now says it had agreed to repurchase the inventory in 2001. That made the transaction a financing, not a sale, and no income should have been reported.

The net result of all the changes, G.M. said in a filing with the Securities and Exchange Commission yesterday, is that its profits from continuing operations will be reduced for every year from 2000 to 2002, increased by a small amount for 2003, and left almost unchanged for 2004.

The more important change for the future is that G.M. will now have \$548 million in a deferred credit for the supplier discounts it previously reported but had not earned. That means that pretax profits in 2006

and later will be that much higher because the credits it wrongly took earlier will now be available again.

"We call that *déjà vu* earnings," Mr. Mulford said.

Investors reacted calmly. G.M. stock, which had closed as high as \$93.62 in 2000, when it reported the profits it is now changing, fell 5 percent yesterday, to \$21.13. But that was still well above the recent low of \$18.33, set Dec. 29, when worries over how the company would meet its retiree health care obligations were high.

While its bonds sagged, they, too, remained above recent lows. A bond issue due in 2033, with an 8.875 percent coupon, fell to 71.5 percent of par value. That raised its yield to maturity to 11.92 percent, from 11.40 percent a day earlier. But that bond traded as low as 61.25, for a yield of 13.89 percent, on Dec. 29. (Prices and yields move in opposite directions.)

Moody's, which may cut ratings again, now rates them B2, which it defines as bonds that "lack characteristics of a desirable investment."

G.M. said it would file the annual report within two weeks, after it quantifies the cash flow issues.

"Accounting problems and restatements are never good, and they certainly don't inspire confidence in management and corporate controls," wrote Shelly Lombard, a bond analyst with Gimme Credit. "But this restatement, while G.M. says it may be material, sounds like a reclassification of cash flows, not a reduction."

She added that while a delayed filing of G.M.'s annual report was not likely to lead to a bankruptcy filing, "G.M. has enough other reasons to file bankruptcy eventually, and we remain negative on G.M. bonds."

G.M., which had a triple-A rating for 28 years, and an investment-grade rating for another 24, was dropped to junk status less than seven months ago. The fact that analysts now think a bankruptcy is possible is a mark of how far the mighty have fallen.

Micheline Maynard contributed reporting for this article.