Seminar

Addressing Information Gaps in Business and Macro-Economic Accounts to Better Explain Economic Performance

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Financial reporting of public companies in the US
Robert C Pozen
Financial Reporting of Public Companies in the U.S.

Robert C. Pozen
Chairman
MFS Investment Management®

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Agenda

• Basic Reporting System
• Delivery of Information
• Application of Accounting Policies
• Current Substantive Issues
• Key Procedural Issues
• Convergence of GAAP-IFRC
Array of SEC Reports

- Annual 10Ks and quarterly 10Qs
- Proxy statements and glossy annuals
- Requirements for financial statements: delegated by SEC to FASB
- Textual disclosures mandated by SEC
Public Company Perspective

• Financial reports
  – Certified by CEO and CFO
  – Reviewed and/or audited by external auditor

• Companies file reports with SEC

• Reports reviewed, but not approved, by SEC staff

• SEC can and does bring enforcement suits
Delivery of Reported Information

• XBRL: Gradual implementation
  – Furnished, not filed
  – No auditor assurance
• Executive summaries
• At front of 10Ks and 10Qs
• More use of corporate websites
  – Advantage of hyperlinks
  – Call for legal clarification
Key Performance Indicators (KPIs)

• Industry development of terms
  – Consistency
  – Comparability
• Increasing use in earnings release
• Voluntary disclosure in SEC reports
• Comparison to MD & A
Financial Restatements

Market Reaction to Restatement Announcements

Correction vs. Restatement

• All errors, other than clearly insignificant errors, should be promptly corrected and disclosed in the current period

• In the “dark period” during the restatement process (e.g., 1-2 years), investors receive little information

• Therefore, prior period financial statements should be restated only if the error is material to current investors
Accounting Judgment

• Increased role of judgment
  – Fair value estimates
  – Principles vs. rules

• Policy statement, not “safe harbor”

• Disciplined consideration of factors
  – Material facts of transaction
  – Alternative accounting views
  – Review relevant literature
  – Known diversity of practice
  – Documented rationale for alternative chosen
Go Slow on Fair Value

• Financial instruments
  – Held to maturity
  – Available for sale
  – Actively traded
• Other types of assets and liabilities
• Fluctuations in value
  – Unrealized gains and losses
  – Capital implications
Division of Income Statement

• Cash flows
• Net operating income
• Sale of securities
• Unrealized income
  – Securities trading portfolio
  – Currency fluctuations
  – Unfunded pension liabilities
Bright Lines in Leasing

• Under current rules, a lease is recognized – all or nothing - depending on whether it meets the 90% test

• Alternative approach: Proportionate recognition
  – Lessee has right to use a machine for four years
  – Machine valued at $100, has a 10-year useful life
  – Lessee would recognize $35 on its balance sheet (NPV using that machine for 4 years)
Off-Balance Sheet Rules

• Easily avoid consolidation under current rules
  – Voting control test
  – Risk/reward test

• Proposal: Require independent holder of substantial equity to have governance role

• Disclosures by sponsor
  – Informal and formal obligations
  – Likelihood of future consolidation
Standard-Setting at FASB

• Central committee for agenda
  – Prioritize items
  – Drop projects
• Field testing and user pre-reviews
• Post-adoption review of standards
• Better design and clearer standards
Implementation Guidance

- Support clarification of GAAP
- Label non-authoritative guidance
- SEC takes lead in guidance
  - Specific to one registrant
- FASB (or SEC if necessary) issue broader guidance after notice and comment
Paths to Global Convergence

• SEC considering several paths
  – Target date for convergence
  – Option for U.S. companies
  – Option until target date

• Have to restructure the governance process
  – Role of oversight foundation
  – Role of national regulators

• Have to reconcile remaining accounting differences
  – Merger of FASB-IAB
  – Several years to complete
Interpretation of Global Standards

• Standards will use more principles and fewer rules
• IAB issues 2 or 3 interpretations each year
• Will national regulators be allowed to issue interpretations of global standards?
• Will U.S. GAAP continue to apply to private companies and non-profits?
Conclusions

• US reporting system is strong
• Procedural issues being resolved
• Historic costs vs. fair value
• Slow move to global convergence