

Financial Reporting in the Era of Sarbanes Oxley: Tactical Issues & Insights

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Financial Standards: What We Do

- Helping executives confidently present financial results to the public
- Big Four practice offices
- Independent third parties for fair values of financial instruments;
- Problem accounting: derivatives, hedging, and stock option accounting
- Accounting/regulatory research
- Board of Directors/Audit Committee



Tactical Issues and Insights

- 1) Post Sarbanes Oxley Wall Street
- 2) Who's Looking at your financials?
- 3) Shareholder Report Regulations
- 4) Costs
- 5) IR Wish List and Financial Supplements

What is Happening on The Street? :

- Relationship between banking and research under attack
- Half as many analysts today as two years ago-- Cover fewer companies
- Publish less & spend more time on administrative CYA
- Compensation down
- Pressure up

Who is Looking at Your Financials?

- Predictions
- More independent research
- Sell-siders move to buy-side
- Analysts will not own stocks they cover
- Commissions & investment banking fees decline
- End of analyst reports as company PR
- No sponsorship for small-cap companies
- Quality and quantity of investment research will suffer

Shareholder Reporting Regulations

- Reg FD changed the analyst/public company relationship
- Added meaningless disclosure and impenetrable paper blizzard
- Regulation AC
 - We certify that the views expressed in this research report accurately reflect our personal views about the subject securities or issuers; and we certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

No report previews for bankers or companies

Constrained dialogue between analysts and companies

No more heads up on ratings change



Realities of Financial Review

- Shorter reporting cycle= lower quality research
- No communication between bankers & analysts
- Limited role in banking deals
- Media appearances limited- new disclosure requirements-
- Simplified (and simplistic) ratings- Buy/Hold/Sell

Costs

- Increases size threshold to be a public company
- Costs will increase
 - **D&O Insurance**
 - **Audit Fees**
 - **Legal Fees**
 - **Internal Staff (accounting & audit)**
 - **Directors fees (may be self-defeating)**

Post Sarbanes Oxley IR Wish List

- **Management and directors should buy stock- and have significant net worth in the company**
- **Eliminate classified/staggered boards**
- **No management employment contracts**
- **Eliminate special management retirement programs**
- **Only one management director**
- **Simple majority for all shareholder votes**
- **Implement all SOX requirements including board structures and establish strong committee charters**
- **Disavow state anti-takeover provisions**
- **ISS CGQ ranking system**

Supplemental Financial Reporting

Do you use Non-GAAP measures in reporting financial performance?

Do you provide estimates?



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Non-GAAP Measure is a Broad Term

- **SEC specified that the term “non-GAAP measure” is intended to capture all measures that have the effect of depicting either:**
- **A measure of performance that is different from the presented in financial statements, such as income or loss before taxes or net income or loss, as calculated per GAAP; or**
- **A measure of liquidity that is different from cash flow or cash flow from operations in accordance with GAAP.**
- **Example of a non-GAAP measure is a measure of operating income that excludes one or more expense or revenue items that are identified as non-recurring.**

Using Estimates

- An analyst's job is to provide an estimate of a company's performance over the next 12-24 month period.
- **Key Statistics:**
 - Industry specific
 - Trends
 - Cost of debt capital
 - Operating costs
 - Capital Expenditures

Company Financial Supplements

- SEC Disclosures that should be disclosed more than once a year:
- Related party transactions
- Stock option compensation
- Pension plan reporting effects
- Effects of other post-employment benefits programs
- Restructuring of liabilities
- Accounting policies
- Corporate governance issues
- Revenue recognition policies, particularly for TRS



Company Financial Supplements

- **Disclosures:**
- Notes regarding changes in accounting policies and estimates and if prior year financials are required to be restated.
- Covenants-often have to search SEC documents to get an understanding of key covenants.
- Fair value of guarantees- Interpretation 45
- Special purpose and variable interest entities.
- Off-balance Sheet Arrangements
- Debt table with scheduled maturities.
- Accounting policies involving estimation risk.

Recommendations

- Make supplemental an Executive Summary to fit broad range of investors
- Sell-side analysts
- Buy-side analysts
- Fixed-income investors
- Retail Investors