By Stephen Barlas, Karen L. Jett

GOVERNMENT

Corporate Disclosure of Credit Rating Agency Relationships

By Stephen Barlas, Editor

Don't look now, but the Securities & Exchange Commission (SEC) wants to require a whole new set of corporate disclosures having to do with credit ratings on corporate debt. The SEC proposed this broad initiative on October 19, and not only has there been very little discussion, but the initiative seems to come out of left field. The SEC held a big roundtable last April on credit rating agencies, during which there was the requisite handwringing about faulty ratings by Standard & Poor's (S&P) and Moody's of structured finance products and the resulting financial crisis that's still reverberating. No one suggested ratings on corporate bonds was a big problem, although Sean Egan of Egan-Jones, which is an investor-supported agency—as opposed to issuer-supporter—did point to ratings of debt from companies such as Fannie Mae, Countrywide, Bear Stearns, and AIG and noted those rating were equally problematic. Nonetheless, the SEC, in its briefing paper for the roundtable, gave no indication that corporate disclosure was up for grabs. Fast forward to the October 19 proposed rule. There the SEC says it wants to issue rules that will require companies to disclose ratings assigned by credit rating agencies to classes of debt securities, convertible debt securities, and preferred stock in registration statements and periodic reports. Item 10(c) of Regulation S-K currently makes these disclosures voluntary—and the disclosures are made infrequently. The SEC would require disclosure of all material scope limitations of the credit rating and any related published designation, such as noncredit payment risks, assigned by the rating organization with respect to the security. In addition, in order to highlight potential conflicts of interest, the proposed rule would require disclosure of the source of payment for the credit rating. Also, if any additional nonrating services have been provided by the credit rating agency or its affiliates to the registrant or its affiliates over a specified period of time, disclosure of the services and the fees paid for those services would be required. Disclosure would be required in Securities Act and Exchange Act registration statements. The SEC even wants to go so far as to require disclosure of preliminary ratings, as well as final ratings not used by a registrant, so that investors will be informed when a registrant may have engaged in ratings shopping.

Previous efforts with regard to reforming credit rating agencies haven't worked out so well.

What the SEC doesn't say in the proposed rule is that its previous efforts with regard to reforming credit rating agencies haven't worked out so well. Part of that is the fault of Congress. It passed the Credit Rating Agency Reform Act of 2006, and the SEC dutifully rolled out five rulemakings, including some liberalization of the ground rules for a credit rating agency to become a Nationally Recognized Statistical Rating Organization (NRSRO), which is allegedly the gold standard. Moody's, S&P, and Fitch (the Big Three) had already attained that status. But Congress and the SEC wanted to get more competition. Hence the expansion of NRSROs, which now number 10. But that growth obviously did nothing to prevent last fall's financial meltdown, caused in part by ridiculous ratings on structured finance instruments. SF

BOOKS

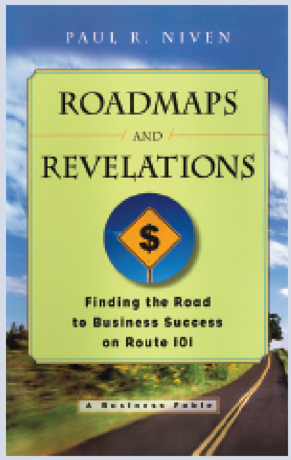
The Strategic Planning Process

Imagine that you are attending your annual planning retreat and are getting ready to depart for vacation when you get pulled into one more “important” meeting. At this meeting, you’re notified that the existing owner has sold the business, and the new owner is looking to you to create a strategic planning process within the next few days.

That’s what happens to Rory in Paul Niven’s *Roadmaps and Revelations*. It might not have been too bad, but, like many privately held businesses, the planning process actually consisted of making and tracking an annual budget based on the vision of the owner of the company. Using a parable format, the story of *Roadmaps and Revelations* follows Rory as he learns how to create a successful business strategy while driving to a family reunion.

As management accountants, we tend to be like Rory and focus on the financial and measurable aspects of strategic design. We’re often relegated to the role of creating the associated budget and reporting back on whether the strategic plan has been met based solely on whether or not the budget has been exceeded. The theme of *Roadmaps and Revelations*, however, is that strategic planning is much greater than annual budgeting.

Underlying the entire lesson in strategic planning is the definition of strategy as “the broad priorities adopted by an organization in recognition of its operating environment and in pursuit of its mission.” While this may sound a bit broad and overwhelming, it serves to simplify the entire strategic planning process.



Niven believes an organization’s mission is key to the strategic planning process because it “defines your reason for being as an organization beyond succeeding financially.” Once you understand this reason for being, it acts as a guide through the rest of the process. Ultimately, the entire strategic plan should link back to the core mission. Because the mission statement is so important, Niven makes sure that *Roadmaps and Revelations* includes the characteristics of an effective mission statement, a process to discover it, and examples.

Once this important groundwork is completed, work on the actual strategy can begin. The four key questions to consider are:

1. What propels us forward?
2. What do we sell?
3. Who are our customers?
4. How do we sell?

Each of these questions may have several answers, but it’s important to identify the single answer that best describes your company. If the strategic team fails to identify the core competencies at this point, it will end with a diluted plan that doesn’t provide clear direction instead of a strong plan with a laser focus.

Ideally, a strategic plan is focused enough to provide clear direction and yet flexible enough to allow the company the ability to adapt to changing conditions as time goes on. This is accomplished by identifying core competencies and how they interact with each other. Finally, the entire strategic process is boiled down and refined into a short statement that’s easily understood and remembered.

Niven does a great job of taking a complex subject and making it easy to understand and implement. I would even go so far as to say that his book is fun to read, with the only caveat being that Niven can be prone to excess hyperbole.

Don’t be like Rory and focus only on the financial aspects of strategy. You can become a more strategic partner in your company by reading and learning the concepts explained in this book.

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