SF bulletin

By Adel Abutarboush, Amanda Balbi, Stephen Barlas

GOVERNMENT

SEC Chair Pushes for Disclosure Relief

By Stephen Barlas

The Securities & Exchange Commission (SEC) is readying a study authorized by Congress that examines potential financial reporting requirements that can be eliminated. SEC Chair Mary Jo White has been talking up the notion of relieving corporations of having to disclose information no longer deemed "material" so that investors have an easier job of understanding 10-Ks and other financial reports. Section 108 of the 2012 JOBS Act requires the SEC to comprehensively analyze the rules that form the underpinnings of the SEC's disclosure regime. The JOBS Act included provisions aimed at making it easier for emerging companies to go public, in part by reducing their disclosure requirements such as those having to do with reports on internal controls. The SEC Division of Corporation Finance is finalizing this report, and White says it's expected to be made public very soon. The odds are that those recommendations will focus on going beyond the JOBS Act provisions for "emerging" companies, and reporting relief for big corporations may be in the offing as well. Of course, Congress would have to turn any SEC recommendations into legislation, which would have to pass both houses.

White has been talking up the need for corporate reporting simplification and slimming. In a speech, "The Path Forward on Disclosure," in mid-October to the National Association of Corporate Directors (NACD), White said, "The study is only the first step in any potential review effort. Such a review will need to be guided by answers to a host of questions that will move us forward on the path to more optimal disclosure. It is an important priority for me."

One group of items that she singled out as being ripe for review is the industry guides the SEC issues for various sectors. The oil and gas industry guide was last updated in 2008. Also on deck are the guides pertaining to the mining industry, bank holding companies (originally published in the 1960s), and others. "An update to these guides could take a variety of forms," White explained in her NACD speech. "We could merely update them as guidance, or we could adopt actual rules. We would need to consider whether and how companies and investors would benefit from these options."

White's intentions are hardly revolutionary, but she has also been sounding something of a radical notion in another area—to a polite degree decrying Congressional mandates that seem more directed at exerting societal pressure on companies to change behavior rather than to disclose financial information that primarily informs investment decisions. That soft criticism refers to a mandate from the Dodd-Frank Act that companies disclose involvement in extracting conflict minerals that originate in the Democratic Republic of the Congo or an adjoining country. She added, "I must question, as a policy matter, using the federal securities laws and the SEC's powers of mandatory disclosure to accomplish these goals."

XBRL Relief Proposed for Some Companies

White's increasingly public comments about "disclosure overload" are beginning to echo around Washington, D.C. Tom Quaadman, vice president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce, referred to them during hearings in the House Financial Services Committee on October 23. Quaadman brought up White's recent comments when discussing a bill that would exempt certain companies from having to file certain reports in eXtensible Business Reporting Language (XBRL). In early 2009, the SEC published three final rules requiring XBRL-tagging of certain disclosure information for operating companies,

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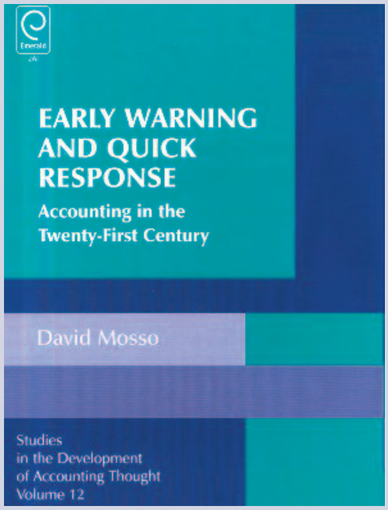
Does Accounting Need a Revolution?

In his book, *Early Warning and Quick Response: Accounting in the Twenty-First Century*, Financial Accounting Standards Board (FASB) alumnus David Mosso admits he helped create an accounting mess, also known as Generally Accepted Accounting Principles (GAAP). "Earnings is the trash can of the accounting process and owners' equity is the dumpster," Mosso says. His bold message, considering who he is, brings to mind the old saying, "The carpenter's door is always broken!"



Mosso spots many problems in the current GAAP accounting model, including a lack of an effective objective, misclassifying some liabilities as owners' equity, and the pick-and-choose allocation process where there's no way to prove that one allocation method is better than another, which makes financial statements almost always incomparable and inconsistent to a large degree. With such problems at hand, the model fails to foresee early warning signals of impending financial crises.

To address these challenges, Mosso proposes new models to replace the current accounting model and the standards-setting process. The first is the wealth measurement model (WMM), where all measurable assets and liabilities must be recognized on an entity's balance sheet and measured at fair value. The result is a balance sheet that displays wealth and an income statement that displays a change in wealth. In addition, unmeasurable assets and liabilities must be disclosed.

Under the WMM, financial statements should be segmented and the capitalization of goodwill prohibited. Mosso believes all entities, including governments and nonprofits, must use the model. He notes, "The mantra for implementation should be: all on, all fair—universal, no choice, no exceptions."

The WMM provides a solution to thousands of accounting standards that govern bits and pieces of financial statements and cost allocation issues (e.g., First-In, First-Out (FIFO) vs. Last-In, First-Out (LIFO)). In addition, the model offers better comparability and helps identify early signals of impending disaster for an entity or industry.

The second model is the quick response model designed to overhaul the standards-setting process. The current accounting model is based on choice and has no compass to guide decision making, which leaves too much room for debate, negotiation, and lobbying.

When adopting the WMM, the proposed standards-setting process will quickly resolve most emerging accounting issues. Furthermore, it will work as an early warning mechanism for spotting problems that might take root and spread throughout an industry under the current process.

I encourage you to read Mosso's interesting and revolutionary work. I'm fond of the strict distinction he makes between liabilities and owners' equity. His argument is compelling and alluring, and so is the treatment of goodwill as an expense.

The only concern is the brief mention of some of the shortcomings of Mosso's models. It leaves me wondering if he makes claims he can't prove. To me, it sounds almost impossible for practitioners to apply the WMM in most cases without intervention from standards setters. It's also unlikely that accountants and the general public will have a better understanding of how the dollar figures are calculated under his new model.

Mosso fails to stress to what extent we can trust companies to use the WMM fairly and how auditors will be able to verify fair value calculations, which involve a great deal of assumptions and estimates for items without quoted prices in active markets.

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mutual funds, and credit rating agencies. One of the bills before the Capital Markets and Government Sponsored Enterprises subcommittee that day would effectively repeal this requirement for firms with total annual revenues of less than $1 billion. Under the bill, roughly three in every four public companies would be exempt.

Quaadman says, “XBRL has been a work in progress and has undergone a number of growing pains. Smaller issuers should be required to use XBRL only after the bugs have been worked out and compliance costs have fallen to the point where they are less than the benefits.”

But Heath Abshure, securities commissioner for the State of Arkansas, who testified on behalf of the North American Securities Administrators Association, Inc., opposed the XBRL bill. He did say, however, “State securities regulators are very sensitive to the compliance cost that XBRL may be placing on some truly small companies, and in the case of such companies, we would hope that Congress and the SEC would afford filers with a more limited exemption, or forbearance, to minimize any excessive cost or burden associated with this new filing protocol.”

SEC Releases Whistleblower Report

By Amanda Balbi

Last month, the Securities & Exchange Commission (SEC) released its annual report on the Office of the Whistleblower (OWB), “2013 Annual Report to Congress on the Dodd-Frank Whistleblower Program.” The OWB was created under the Dodd-Frank Act, and the program is funded by the Investor Protection Fund established by Congress.

The report found that there were 3,238 tips made this year and 6,573 total tips since the program’s beginning. The amount of whistleblower tips has increased significantly since the program was implemented in 2011. The top three categories reported in 2013 were Corporate Disclosures and Financials (17.2%), Offering Fraud (17.1%), and Manipulation (16.2%)—the same categories as last year.

Individuals can file a report on the SEC’s website or call the hotline, which are both available to a broad audience. Tips not only originate from the United States but also internationally. California, New York, and Florida reported the highest number of whistleblower tips this year, respectively. In addition, 55 countries outside the United States reported tips to the SEC. The United Kingdom, Canada, and the People’s Republic of China reported the most, respectively.

The SEC issues a Notice of Covered Action when a final court decision has been made after a tip leads to the recovery of more than $1 million. Whistleblowers can view the Notices on the SEC’s website and apply for a monetary award by submitting a form. In 2013, 118 Notices were issued, and 431 have been issued since 2011.

The SEC awarded more than $14.8 million to whistleblowers in 2013. The bulk of that, more than $14 million, was awarded in September to a single whistleblower whose tips led to the arrest of perpetrators and recovery of investor funds. Since 2011, six whistleblowers have received awards. Four of them received monetary awards in 2013.

Sean X. McKessy, chief of the OWB, continues to encourage whistleblowers to come forward without fear of retaliation. “At the end of the day, protecting investors is what the whistleblower program is all about,” he said. “OWB looks forward to the continued growth of the Commission’s whistleblower program.”

If you would like to read the full report, visit www.sec.gov/about/offices/owb/annual-report-2013.pdf.

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