

# Market News

**June 2018**

A monthly review of IR developments for our clients and friends. . .

## **SEC looks to whistleblowers to stop deceptive non-GAAP financials**

Critics have long argued that GAAP's requirements are too rigid to accurately reflect financial performance. Companies are increasingly including adjusted non-GAAP numbers in their financial reporting to give investors a "truer" picture of their performance. In 2013, approximately 60 percent of S&P 500 companies reported at least one non-GAAP earnings figure, according to FactSet. Today, 90 percent do. The problem is that their adjusted numbers often paint a rosier picture than their reported GAAP numbers – maybe too rosy. A 2017 survey of nearly 400 CFOs revealed 20 percent of companies intentionally distorted earnings while adhering to GAAP, increasing their bottom line an average 10 percent. In response to the widespread abuse of GAAP, the SEC is encouraging employees, including accounting staff and auditors, to report non-GAAP abuse through their Whistleblower Program that carries the incentive of a cash reward.

## **IRS offers automatic method to convert accounting for new revenue recognition standard**

In May, the Internal Revenue Service introduced a procedure allowing companies to automatically conform to the Financial Accounting Standards Board's new revenue recognition standard. Revenue Procedure 2018-29 enhances the procedure issued last year by allowing for automatic consent from the IRS for the change in recognizing revenue in a financial statement for goods and services promised to customers in an amount that reflects what the entity expects to receive in exchange for those good and services. A full description of the procedure can be found [here](#).

## **How fund managers see the 2018 economy**

The Bank of America Merrill Lynch Global Fund Manager Survey revealed expectations for the slowest economic growth since early 2016 in 2018. Of the 223 fund managers participating in the survey, 41 percent believe we will see a recession in 2019, while 43 percent predict a recession in 2020. Higher inflation is the main concern in 2018 for 79 percent of the participants. Finally, the cash balance of mutual funds is down for the year from five percent to 4.9 percent, an indication of uncertainty in the economy, according the study's authors.

## **Think twice before barring press from your annual meeting**

Some companies have opted for virtual annual meetings to keep activists and the press at bay. Others prefer to restrict meeting attendance to registered shareholders on the record-date list, barring even street-name holders. If you choose the latter path, as companies like Harley Davidson, Macy's, VF Corp. and McDonalds have done, a corporate governance expert says to make sure you consider the negative press coverage you will likely receive. Nell Minow, editor of The Corporate Library, thinks that it's best to let the press in, so non-attending shareholders can learn from their reporting how the board and executives present themselves and how they respond to questions. Minow said, "If the answer is cutting off access to the press, the obvious question is, What are they trying to hide?"

### **A disconnect between executive pay and performance**

For years, corporate boards have tried to tie their chief executives' compensation to performance, but they still aren't doing it right. A *Wall Street Journal* study of 4,000 CEOs using 2017 data from MyLogIQ and Institutional Shareholder Services showed a disconnect between performance and pay. Ten percent of CEOs receiving the biggest pay increase scored in the middle of the pack on shareholder return, while companies delivering the top 10 percent total return scored in the middle of the pack in terms of CEO pay. Study authors noted that many boards set CEO pay by benchmarking to the average compensation of CEOs at peer companies. CEOs' job responsibilities and performances vary greatly, however, making this measurement meaningless.

### **Investors create mock "integrated" annual, but issuers say it's not that easy.**

Some investors would prefer to receive an "integrated" annual report combining elements of the 10-K, proxy, and regular annual. One group recently assembled a 40-page mock integrated report for ExxonMobil. A *Forbes* report on their efforts said it took about 40 hours to do, and will be faster when they complete work on a template tool. Issuers, who are legally responsible for such content, say 40 hours isn't realistic given the layers of review a company must go through.

### **Changes to Dodd-Frank rules include Reg A+ option for some listed issuers**

One overlooked provision of the new Economic Growth, Regulatory Relief and Consumer Protection Act represents Republicans' effort to stimulate the public offering market by giving already-listed companies the right to use the simpler Reg A+ process for offerings. That option had been available only to IPOs. Every company listed on a national exchange and many that trade over-the-counter will be able to complete equity offerings under Reg A+ if they would have been eligible as a private company. Now, many smaller listed and OTC companies can complete offerings of up to \$50 million while avoiding state blue-sky review, and using "testing the waters" notices to the general public.

### **DOJ applying new corporate compliance standards**

The Department of Justice is advising companies that it's paying more attention to the quality of compliance policies in effect before a violation is detected, and less to the fixes that follow. Deputy Attorney General Rod Rosenstein told corporate compliance officers in Washington that if the DOJ finds that a weak "paper" policy was in effect when a violation occurred, the DOJ will be far less forgiving than if the former program was robust, even if it was thwarted. He said the DOJ's new policy for pursuing Foreign Corrupt Practices Act violations includes the same retrospective assessment. Starting last November, companies that promptly report their own FCPA misconduct and fully cooperate by adopting remedial measures will get a better DOJ response, especially if the compliance program that was violated was reasonably effective.

### **Governance experts pushing to stop 'formula swapping' on shareholder proposals**

Governance advocates are focused on a practice known as "formula swapping" and its effect on the success of shareholder proposals on corporate ballots. In particular, they are pressing for more corporations to adopt what they call "simple majority" voting for all proposals. That means ignoring abstentions and counting only "for" or "against" votes to determine the outcome of all proposals. Advocates like Bruce Herbert, CEO of Newground Social Investment, say that formula swapping has affected the outcome of numerous proposals that would have been approved if abstentions had been excluded from the count, as is the case with director votes. Since a 2013 CalPERS study revealed that more than half of American companies practice formula swapping, more than 30 have converted to the simple majority standard.



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please contact us at (937) 434-2700, or e-mail [ctc@irbyctc.com](mailto:ctc@irbyctc.com)*