

Market News

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

It's official: We're all XBRLers now

By a 4-to-1 vote, the SEC has ratified Chairman Christopher Cox's long campaign to mandate the use of extensible business reporting language, or XBRL, in SEC filings. The change begins in June 2009 for the biggest 500 companies, other accelerated filers in 2010, and the rest the following year. Cox calls the change a "step from document disclosure to data disclosure" that will make it easier for investors to use financial information. The SEC had hoped for voluntary compliance, but only 100 companies had responded to the SEC's four-year campaign. Now the SEC will insist that all companies report in ways that allow users of the data to access and analyze it with their own analytical software tools, or the SEC's own tools built into its Interactive Data Electronic Applications, or IDEA, platform. The mandate is also getting applause from a wide range of consultants and software developers eager to help companies with the changeover. One such firm, Rivet Software Inc. of Denver, expects its revenues to soar and staffing to more than double in 2009. Companies, however, are less enthusiastic, with some sarcastically referring to it and pending international accounting rules as "Sarbox II," with even greater conversion costs and unforeseen consequences.

CFAs would keep research spending 'soft'

In a quick snapshot survey, investment-manager members of the CFA Institute have indicated that they are at least willing to disclose more information about their "soft dollar" purchases of securities research, if not ban the practice outright. Asked to comment on the topic in November, nearly 60 percent indicated that they think the practice of paying above-market commissions to trading firms in exchange for "free" access to research services is acceptable, so long as the practice is fully disclosed to investors. A third thinks the practice should be banned outright, with research paid for separately from trading fees, and billed separately to investors in a management fee. Several who commented on the CFA's website called the "soft dollar" practice unethical, because it hides the degree to which investment managers rely on outside analysis, and doesn't show explicitly what it costs.

What should you know about a CDO?

The recent appointment of LCH Clearnet to be a clearinghouse for credit default obligation (CDO) transactions may shed light on trading in the \$60 trillion market, but the step does not represent regulation of the instruments themselves, or of their issuers. As such, it's a long way from transparency into the CDO market that the Treasury and Congress have called for, and it's not clear whether the SEC will permanently adopt the LCH plan for trading information. The Commodity Futures Trading Commission is looking at other approaches, with other clearinghouse vendors. Expect a long jurisdictional battle before any light shines on CDOs.

Sarbox de-clawed by court ruling

Sarbanes-Oxley requires CEOs and CFOs to give back performance-based pay if the performance is later wiped out in a restatement. But a federal judge has decided that the pay penalty doesn't apply if the company doesn't actually file the restatement, even if one is evidently called for. U.S. District Judge Jean Hamilton wrote that "before penalties may be imposed, an issuer must be compelled or ordered to prepare a financial restatement, and must actually file the restatement." The case was options backdating by executives of Engineered Support Systems, who admitted wrongdoing but never filed restated financials to reflect the effect of the backdating prior to the company being acquired. The indirect effect of the ruling may be that top executives are even more conflicted about close-call restatements.

Don't blame fair value

The SEC is again defending mark-to-market accounting for financial instruments against charges that they contributed to the credit crisis, but concludes that the rules need more common-sense interpretations than they are getting by auditors. The study, ordered by Congress, largely tracks earlier SEC guidance that the rules need FASB tweaking, which might yet happen in time for 2008 year-end reporting. The SEC says investors still think fair-value accounting leads to more transparent financial reporting, and said banks got in trouble not because of accounting treatments, but mainly from bad credit decisions. SEC supports changes for fair-value determinations when markets don't exist or aren't working, including when it's okay to rely on management judgment. In general, the SEC wants fewer impairment models, more management discussion about credit quality, and ways to show impaired-asset impact without affecting net income. Cindy Fornelli, director of the Center for Audit Quality, is pleased to see a reaffirmation of fair value, but wants changes to flow through the independent standard-setting process.

Comeback for IPOs unlikely

Grant Thornton advisers David Weild and Edward Kim say nobody's willing to reward anybody for recommending small-cap IPOs, so don't expect them to flourish again soon. Discounted commissions and decimalization have more to do with their prediction than Sarbanes-Oxley hurdles for would-be issuers. Weild says \$25 online trades have wiped out \$250 broker-assisted trades, and it took the latter to make it worthwhile for a broker to promote small-cap IPO shares to clients. Also, the decimalization of the exchanges in 2001 shrunk market-maker spreads, squeezing another key section of the small-cap IPO pipeline, says Kim.

Should courts bail out Phyllis Molchatsky?

The 61-year-old retiree lost nearly \$2 million to Bernard Madoff, and is suing to get most of it back from the hide of the SEC for not doing its job. Her lawyer, Howard Elisofon, thinks the SEC "fell down on the job in this instance," and noted that John McCain also targeted the SEC and Chairman Cox for principal blame during the 2008 presidential campaign. Most other lawyers think the SEC has a pretty protective bulletproof vest against such cases in the form of sovereign immunity, but won't completely rule out Molchatsky's chances. "It's an uphill battle to succeed with this," one said. We're rooting for her, of course, to get at least far enough to generate some contrite testimony under oath from a few SEC principals. That might not be worth \$2 million to Molchatsky, but it would make a lot of other investors feel a bit better about their own tattered portfolios.



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