

Restoring Credibility and Winning Stakeholders Trust

Source: BUILDING PUBLIC TRUST: THE FUTURE OF
CORPORATE REPORTING, Wiley, 2002.

Critics are questioning key components of the U.S. capital markets:

- The rules of disclosure,
- The actions of the analysts,
- The responsibilities of outside directors,
- The ability and the will of the accounting profession to protect investors,
- The integrity of our capital markets.

Issues important to the efficacy of the financial markets and the protection of the investors:

1. How investors determine and assess “value”.
 - The market is valuing companies at huge multiples of GAAP-determined figures.
 - Too little time is spent assessing the continued relevancy of this model in today’s technology-driven, Internet age.
 - We must find ways to provide to the investor information that is more relevant in an environment of large market cap-book value differences.

2. How we reduce stresses on the financial report process.

- The root of the problem is a system based on making and meeting short-term earnings forecasts that generate continuous pressure on company management to deliver earnings consistent with the analysts' expectation (“the earnings game”).

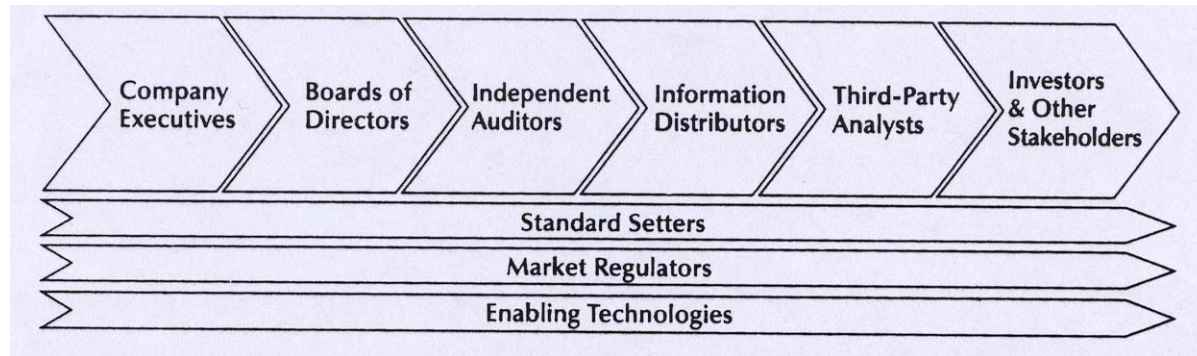
Key Elements of Public Trust

1. Spirit of Transparency. Corporations have the obligation to provide willingly to stakeholders the information needed to make decisions. Failure to do so is often based on the mistaken belief that playing “the earnings game” - managing and beating the markets’ expectations about next period’s earnings - will increase shareholders value.

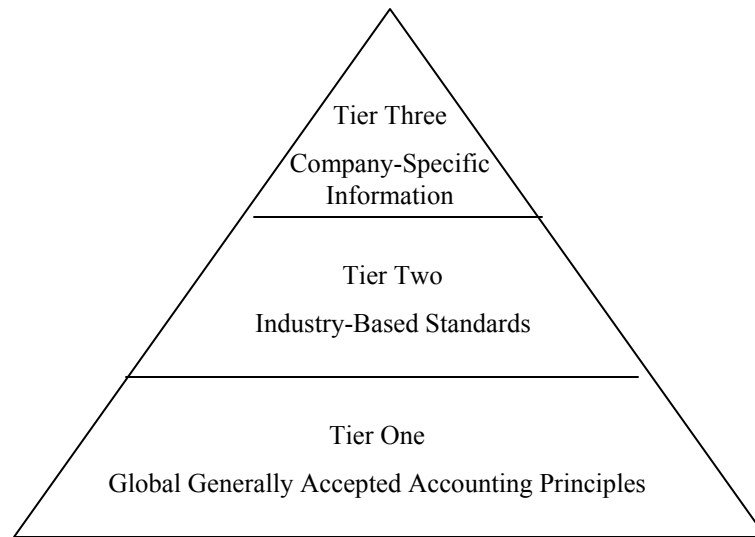
Key Elements of Public Trust (cont'd)

2. Culture of Accountability. The accountability is collective - every member of the corporate reporting supply chain must be held accountable and must commit to collaborating with all others.
3. People of Integrity. Transparency and accountability are not enough to establish public trust. In the end, both depend on people of integrity.

The Corporate Reporting Supply Chain



The Three-Tier Model of Corporate Transparency



The model's three tiers include:

1. A set of truly global generally accepted accounting principles (Global GAAP).
2. Standards for measuring and reporting information that are industry-specific, consistently applied, and developed by the industries themselves.
3. Guidelines for company-specific information such as strategy, plans, risk management practices, compensation policies, corporate governance, and performance measures unique to the company.

Criticisms of GAAP Today

1. Fosters “The Earnings Game” played by both management and the markets since earnings has long been the single most important measure of performance.
2. Does not account for or disclose certain types of information about intangible assets.
3. Does not communicate adequate information about value creation because it is a mixed model that includes historical cost, amortized cost, written down cost, and fair value for certain financial instruments and other assets in some countries and industries.

The Case for Tier-Two Standards

- GAAP-based financial statements are important, but they do not cover all of the value drivers, many of which are non-financial in nature.
- The complete set of value drivers differs significantly across industries.
- Different industries often define and measure the same value driver differently.
- Most important, different companies within a single industry often define and measure the same value driver differently.

Key Value Drivers for Executives in the Pharmaceutical and Telecommunications Industries

Pharmaceuticals	Telecommunications
Earnings	Earnings
Performance by business segment	Cash flow by business segment
Market growth and potential by therapeutic area	Revenue metrics by driver
Market growth and potential by geographic area	Significant operating costs by category
Market share by therapeutic area	Capital expenditures
R&D pipeline	Competitive landscape
Product focus strategy	Market growth
Product innovation strategy	Network reach, quality, and capability
Effectiveness of product launch	Pricing strategy
Reputation with prescribers	Sales and marketing strategy
Regulatory issues	Customer churn rate
Quality of management	Regulatory environment

Executive Perceptions of Eight Value Drivers*

Value-driver category	Important for creating shareholder value over the long term	Has a high impact on future financial performance	Use the measure in evaluation and decision making
Product and service quality	89	86	83
Customer satisfaction and loyalty	83	86	73
Operational efficiency	75	75	72
Current accounting results	71	62	81
Product and service innovation	62	60	54
Employee satisfaction and turnover	47	44	38
Alliances with other companies	20	22	17
Community involvement and environmental performance	11	8	11

Note: The left-hand column lists the categories of value drivers tested, while the statements across the top of the chart reflect how executives perceive or use each value driver. The figures record percentage of executives who agreed with the statements.

* All percentages evaluated on a five-point scale, with 5 the highest and 1 the lowest rating. Percentages are based on respondents who responded with a 5 or 4 to the questions.

Reporting Gaps by Industry

Industry	Market growth	Market share	Corporate strategy	Earnings	Cash flow	Segment information	Product innovation	Customers	Quality of management
Banking	•		•					•	•
Chemicals			•				•	•	•
Consumer products		•	•				•	•	•
High tech	•	•					•	•	•
Insurance	•		•				•	•	•
Investment management	•		•			•	•	•	•
Pharmaceuticals							•	•	•
Real estate							•	•	•
Retail	•	•				•	•	•	•
Telecommunications	•		•		•	•		•	•

Key: • Large Reporting Gaps exist

Conclusions

The elements of public trust and the information requirements to materialize them rest on a very simple concept -

Demanding and rewarding good management.