



FINANCIAL AND REPORTING PRINCIPLES AND DEFINITIONS



BASIC REPORTING PRINCIPLES

- Full Disclosure of Meaningful Information
 - Basic facts about an investment should be available prior to buying it.
 - Investors (or regulators) should be able to judge for themselves if a company's securities are a good investment.
 - Consistency
 - Allows for comparisons year to year
 - Allows for comparisons among companies
 - Purpose
 - Should be a clear objective relative to the purpose of the report so preparer can make it meaningful
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REPORTING OBJECTIVES

- From Harvey Kapnick, former council member of the American Institute of Certified Public Accountants
 - Accounting has suffered from a void attributable to a lack of agreement about the objectives of the accounting and reporting process... Objectives, authoritatively supported, could provide the goal, the road map, the unifying force, and the direction needed to stimulate the process by which accounting standards could become relevant and result in truly meaningful and useful financial statements.
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BASIC REPORTING PRINCIPLES

- January, 2002 U. S. Securities and Exchange Commission guidance on disclosures
 - Disclosure must be both useful and understandable
 - Provide most relevant information in language and formats that investors can be expected to understand
 - More useful information in a single location, rather than presented in a fragmented manner

BASIC REPORTING PRINCIPLES

- December 2001 U. S. Securities and Exchange Commission *Cautionary Advise Regarding Disclosure About Critical Accounting Policies*
 - Investors are increasingly demanding full transparency of accounting policies and their effects
 - Even technically accurate application of generally accepted accounting principles may fail to communicate important information if it is not accompanied by appropriate and clear analytical disclosures
 - Each company's management and auditor should bring particular focus to the evaluation of the critical accounting policies used in the financial statements

BASIC REPORTING PRINCIPLES

- December 2001 U. S. Securities and Exchange Commission advice (continued)
 - Management should ensure that disclosure is balanced and fully responsive (e.g., what judgments used, etc.)
 - Prior to finalizing and filing annual reports, audit committees should review the selection, application and disclosure of critical accounting policies
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MORE FINANCIAL REPORTING PRINCIPLES

- From Council on Corporate Disclosure and Governance – Singapore
--Objectives of Financial Statements
 - Provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions
 - Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.
 - Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management.

MORE FINANCIAL REPORTING PRINCIPLES

- Continued from Singapore

- Underlying Assumptions and Qualitative Characteristics

Accrual Basis

Going Concern

Understandability

Relevance

Materiality

Reliability

Faithful Representation

Substance Over Form

Neutrality

Prudence

Completeness

Comparability

Timeliness

Balance Between Benefit and Cost

Balance Between Qualitative Characteristics

AND MORE PRINCIPLES

■ International Accounting Standards

Going Concern

Make assumption going concern unless material uncertainties

Accrual Basis

Use, except for cash flow information

Consistency of Presentation

Presentation and classifications should generally be retained period to period.

AND MORE PRINCIPLES

■ International Accounting Standards (Cont.)

Materiality and Aggregation

Present each material item separately in financial statements.

Offsetting

Assets and liabilities or income and expense should generally not be offset.

Comparative Information

Disclose in respect of the previous period for all numeric information in financial statements and include a narrative description when relevant to understanding current period financial statements.

WHAT TYPES OF REPORTS ARE AVAILABLE?

- Public Reports to Shareholders
- Reports to U.S. Securities and Exchange Commission or Other Country Equivalent
- Annual Reports to Regulators
- Reports to Taxing Authorities
- Others?

REPORTS TO SHAREHOLDERS

- Principle document used by most companies to disclose corporate information to shareholders
 - Usually a state-of-the-company report
 - Nearly all of it is written by Management and is Management Representations
 - Letter from CEO
 - Management Discussion and Analysis
 - Financial Results, Footnotes, and Auditor's Opinion
 - Results of Corporate Operations
 - Corporate Highlights and Future Plans
 - Discussion of Previous Year's Activities
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USE OF PUBLIC REPORTS

- How can publicly available reports, not specifically designed for regulators, be useful?
 - Comparisons of Costs, Revenues, Expenses to those reported to regulators
 - Better understanding of unregulated activities and their impacts on regulated activities
 - Is there a proper allocation of costs to regulated/unregulated?
 - Is the availability of capital constrained because of the capital needs of other businesses of the company?
 - Lots of explanatory information in the footnotes
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OFFICER CERTIFICATIONS

- A new law in the U.S., passed in 2002, now requires that the CEO and CFO certify annual and quarterly reports. Must certify that:
 - The signing officer has reviewed the report
 - The report contains no untrue statement or material omission
 - Report fairly presents all material respects of the financial condition and results of operation
 - Signing officers are responsible for maintaining internal controls
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OFFICER CERTIFICATIONS

- CEO and CFO must certify (continued):
 - Signing officers have evaluated the effectiveness of internal controls within 90 days of the report and presented conclusions about the effectiveness of their internal controls
 - They have disclosed to auditors and audit committee all significant deficiencies in internal controls and any fraud that involves internal controls
 - The report contains an indication of any changes in internal controls.
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DEFINITION OF INTERNAL CONTROL

- A process designed by, or under the supervision of, the company's principal executive or principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, or other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and include those policies and procedures that:
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DEFINITION OF INTERNAL CONTROL

■ (Continued)

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company
 - Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company, and
 - Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.
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INTERNAL CONTROL

- The independent auditor has to attest to, and report on, the assessment made by management regarding internal controls
 - Auditor has to evaluate management's assessment process to be satisfied that management has an appropriate basis for its conclusion
 - Auditor has to test and evaluate both the design and operating effectiveness of the internal control to be satisfied that management's conclusion is correct and fairly stated
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BASIC DEFINITIONS

- Earnings Per Share (EPS)
 - Net Income earned on each share of common stock
 - Net Income divided by Number of Shares of Common Stock

- Dividend Payout Ratio
 - The amount of dividends relative to the company's net income or earnings per share
 - Example: $\text{Cash Dividends} \div \text{Net Income} = \text{Common Stock Dividend Payout Ratio}$

BASIC DEFINITIONS

- Times Interest Earned Ratio

- Can calculate on different incomes (operating income, net income)

(Margin + Interest Expense on Long Term Debt) /
Interest Expense on Long Term Debt

- Debt Service Coverage

(Net Margin + Interest Expense on Long Term Debt +
Depreciation) divided by (Interest Expense + Current
Maturities of Long Term Debt)

BASIC DEFINITIONS

- Commercial Paper
 - Short-term, unsecured promissory notes sold by large companies in order to raise cash
- Beta
 - The relationship between an investment's returns and the market returns. This is a measure of the investment's nondiversifiable risk.

BASIC DEFINITIONS

■ Derivative

- A financial contract whose value depends on a risk factor, including, but not limited to:
 - The price of a bond, commodity, currency, share
 - A yield or rate of interest
 - An index of prices or yields
 - Weather data, such as inches of rainfall or heating degree days

BASIC DEFINITIONS

- Derivative (Continued)
 - Used in Various Ways
 - Risk Management
 - Hedge the risk due to uncertain commodity prices, interest rates, or foreign currency
 - Trading
 - Speculate based on a view of the future direction of the market
 - Balance Sheet Management
 - Change the nature of a liability (fixed to variable interest rate)
 - Benefit from an asset without buying it (capital lease)

BASIC DEFINITIONS

- Hedge

- To make a commitment in commodities for future delivery in order to avoid risk of price change to such commodity entering into the cost of goods already contracted for manufacture and sale

BASIC DEFINITIONS

■ Operating Ratio

- Operating Expense divided by Operating Revenue

■ Debt to Equity Ratio

- Proportion of the total capital provided by Debt compared to the proportion of total capital provided by equity

- Example:

Debt	2,000,000 or 40% of the total
Equity	3,000,000 or 60% of the total
Total Capitalization	5,000,000
Debt/Equity Ratio	40/60

BASIC DEFINITIONS

■ Preferred Stock

- Stock which has a prior claim on dividends (or assets, in the case of the dissolution of the company) up to a certain definite amount before the common stock is entitled to anything

■ Book Value

- The depreciated value of a company's assets less the outstanding liabilities
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BASIC DEFINITIONS

- Price Earnings Ratio (P/E Ratio)
 - Market price divided by Current Annual Earnings Per Share
 - Example:
 - If stock is selling at \$84 per share and earnings is \$7 per share, the price earnings ratio is 12 to 1. This means that the stock is selling at 12 times earnings.
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BASIC DEFINITIONS

■ Yield

- The return on an investment, expressed as a percentage of cost
- Current (or straight) yield is found by dividing the market price into the dividend rate in dollars (for stocks) or interest rate (for bonds).

BASIC DEFINITIONS

■ EBIT

- Earnings before Interest and Taxes.
- A measure of the company's earnings power from ongoing operations, since it excludes income and expenditures from unusual, non-recurring or discontinued operations.

CREDIT RATINGS

■ Issuer Credit Rating

- A current opinion of an obligor's (issuer of securities) overall financial capacity (its creditworthiness) to pay its financial obligations
 - Focuses on the obligor's capacity and willingness to meet its financial commitments as they come due
 - Not a recommendation to sell, buy, or hold
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CREDIT RATINGS

- Long-Term Issue Credit Rating
 - Based on, to varying degrees:
 - Likelihood of payment – capacity and willingness of the obligor to meet its financial commitment on an obligation according to its terms.
 - Nature of and provisions of the obligation
 - Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights
 - Considers the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation
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CREDIT RATINGS

■ Per Standard and Poors

■ AAA

- The highest rating assigned. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

■ AA

- Differs from an AAA only by degree. Capacity to meet financial commitment is still very strong

■ A

- Obligation is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, capacity to meet financial commitment is still strong.

CREDIT RATINGS

- Per Standard and Poors (Continued)
 - BBB
 - Exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.
 - Below BBB (BB,B,CCC, CC, C)
 - Considered to have speculative characteristics.
 - D
 - Payment is in default
 - + or –
 - Show the relative standing within the major rating categories

CREDIT RATINGS

■ CreditWatch

- Highlights potential changes in ratings of bond, short-term, or other fixed income securities
 - Appear on CreditWatch when an event or deviation from an expected trend has occurred or is expected and additional information is necessary to take a rating action
 - Positive – ratings may be raised
 - Negative – ratings may be lowed
 - Developing – events are unclear as to which direction the rating may go
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CONTACT INFORMATION

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