INSIGHT

SARBANES-OXLEY

INSTITUTIONAL PERSPECTIVES

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MAKINSON COWELL

CONTENTS

EXECUTIVE SUMMARY

In July of 2002, the U.S. Congress passed the Sarbanes-Oxley Act. The point of the new law is to restore confidence in the U.S. capital markets in the wake of highly publicized accounting scandals at a number of widely held U.S. companies. The law enables and instructs the U.S. Securities and Exchange Commission (SEC) to implement a dramatically stronger set of securities regulations and criminal sanctions.

Most of the provisions of the new law apply broadly to non-U.S. as well as U.S. companies. This international extension of the law caused an immediate negative reaction from many quarters to the U.S. unilaterally invoking regulations, criminal sanctions and corporate governance requirements on non-U.S. companies and citizens.

The following research has been conducted to examine the views of U.S. institutions on these issues. It is based on interviews with fund managers and analysts who are responsible for researching and investing in non-U.S. companies for 22 leading U.S. investment institutions that together manage over $2.5 trillion in assets.

The great majority of active U.S. overseas investments is accounted for by only about 100 institutions. The sample was selected from this group of internationally sophisticated institutions. Within this group, the sample includes a range in terms of size of institution, investment style and geographic location across the major U.S. investment centers. The following research reflects their views.

HIGHLIGHTS OF U.S. INSTITUTIONAL VIEWS

- The U.S. accounting scandals that led to Sarbanes-Oxley shocked U.S. institutions. They are stunned and dismayed at the extraordinary degree to which major U.S. companies engaged in misleading reporting, outright fraud and simple theft.

- Most, however, do not blame U.S. accounting standards. They believe that U.S. Generally Accepted Accounting Principles (GAAP), UK GAAP and International Accounting Standards (IAS) are all robust systems but that no accounting system is designed to prevent outright fraud and theft by determined, crooked managers.

- There is more blame to be placed on lax boards of directors, auditors and other advisors, flawed compensation systems and the climate of weak penalties and enforcement that prevailed during the bull market. Most of that is being addressed by Sarbanes-Oxley. U.S. institutional investors strongly support those provisions of the legislation as well as the provisions on reporting of executive share dealings (referred to as "insider trading" by many respondents) and restrictions on executive loans.

- These institutions are relatively skeptical that the provision requiring Chief Executive Officers (CEO) and Chief Financial Officers (CFO) to sign financial statements will have much impact on outright fraud. The overall body of new regulation and the ethical turning point it reflects, however, should result in most corporate managements striving to be more conservative and transparent in all of their reporting.

- There is a spread of opinion on whether the U.S. has the moral right or the legal jurisdiction to apply corporate governance rules and legal sanctions unilaterally to non-U.S. companies. The majority strongly believes, however, that non-U.S. companies that are listed in the U.S. should be held to the same reporting requirements as U.S. companies and without exception.

• About half think that many unlisted companies will now be less likely to seek a U.S. listing. They do not think that many currently listed companies will de-list. If a company did de-list it would be a strong signal that it had something to hide and the company would likely weaken its access to capital markets in general.

• Not having a listed US security would likely impair a non-U.S. company's access to U.S. capital. The U.S. accounting scandals have heightened U.S. investors' concern about the disclosure practices of continental European and Asian companies. In today's environment it is more important than ever for non-U.S. companies to provide better detail by business segment, more transparency on provisioning and off-balance sheet items, more timely reporting and more detail on executive compensation.

• Even institutions that do not need a listed American Depositary Receipt (ADR) facility to trade in non-U.S. stocks prefer to own shares in companies that have a U.S. listing. Whilst they may trade the ordinary shares in the local markets, they like having the full disclosure of the 20-F document that a U.S.-listed company has to file annually with the SEC.

• The U.S. investors consider the UK to be the world leader in corporate governance. The U.S. scandals have particularly affirmed the superiority of the UK system of non-executive chairmen and truly independent and vigilant directors.

• According to the sample, many continental European companies have made enormous progress in improving their disclosure and their general communications with investors. Most, however, still have a long way to go to match the disclosure standards of U.S. companies or the governance standards of the UK. Switzerland and the Netherlands are among the best. France is probably the most improved, but from a low base. A handful of top international German companies have improved a lot while many of their compatriots have not. Italy is at the bottom of the list.

• Ultimately, most of these companies need access to the global capital markets. Most of the Sarbanes-Oxley provisions deal with the key issues of disclosure and governance that should be addressed, now more than ever. Non-U.S. companies that recognize the need to respond to these needs in today's environment will have the greatest access to global capital markets at the lowest cost of capital.

• A separate recent Makinson Cowell study of leading global bond managers showed that the bond markets provide no refuge to companies who want to avoid the disclosure requirements of the equity markets. Bond investors too took huge losses in the recent scandals. They strongly intend to push corporate issuers for better disclosure and more active communications in a very similar fashion to equity investors. With the dispersion of corporate bond yields at historic highs, even within a given rating, failure to meet the disclosure demands of the fixed income markets can also have a dramatic impact on a company's cost of capital.

IMPACT ON PREVENTING FRAUD

What is your view of the likely impact that Sarbanes-Oxley will have on preventing future accounting fraud and improving the quality of reporting generally among U.S. companies?

- Most of the investors believe that the new climate reflected by the Sarbanes-Oxley legislation will improve the quality of reporting and reduce the amount of accounting fraud. They attribute the change as much to market forces as to the new legislation. Companies with the slightest hint of accounting improprieties are now having their share prices severely penalized by the market. Any perceived incentives to management to stretch earnings through accounting trickery are now clearly gone. The market in this way was partly to blame for the excesses that led to the scandals. The market is now correcting itself.

- In this new market environment, the respondents expect managers to be less aggressive in accounting practices. Corporate management will be less likely to push interpretation of rules to the limit as in the recent past. One practice that should decline quickly is the use of pro forma earnings computations that paint the best possible picture. During the tech bubble, investors may have suspended disbelief and focused on such figures, but no more.

- Investors also assign a large part of the blame to corporate boards of directors. Directors of U.S. companies have been far too lax in fulfilling their responsibilities to oversee management's practices and look out for the interest of shareowners. The interviewees say that too many U.S. boards are inattentive or incompetent.

- The Sarbanes-Oxley requirement to have CEOs and CFOs certify the accuracy of their accounting statements garnered a lot of high-profile media attention in the U.S. Professional investors, however, are not impressed. They believe that the executives were already accountable and that the wording of the new regulation probably provides as much leeway to claim they were fooled as before. For all the controversy about applying these regulations to non-U.S. companies, the U.S. institutions view it as being one of the least effective parts of the new regulations.

- More than half of the investors are skeptical that new rules and sanctions alone can deter or stop a smart, determined criminal from attempting fraud. They say certain individuals are cheats by nature and will always attempt to beat any system.

NEW CLIMATE
"The market was rewarding managers who were the most aggressive in terms of pushing the limits on the accounting system. Now everyone will be watching that much more closely. The reward system has changed, but it would have been that way without the legislation. The market makes corrections to the excesses of the system once people lose a lot of money."

"The environment will improve, but is it the legislation or the fact that people are going to jail now? I don't know what the cause is but yes, my feeling is that the incentive to stretch has been reduced. The market has reduced that incentive significantly and I think the stocks that have done well are the ones that have been less aggressive, more defensive. I think that has as much impact as any legislation does."

"The law has definitely heightened the attention of corporate financial officers to some of the potential problem areas. We are seeing companies going in and re-examining their procedures and making changes to any practices that might be considered overly risky to investors."

"There will likely be less fraud than in recent years because the opportunity was there and the control was not. I think the quality of reporting will be better. And also Corporate Directors have been very lax. It has in recent years just been a club of people. I have talked to Directors who have no clue what the business is like - there is no excuse for that."

"Historically U.S. companies have been very willing to be less straightforward in their accounting treatments than they ought to be -- the whole issue of pro forma earnings. And if the new legislation encourages them to be at least realistic and consistent in the way they report their numbers then I think it's a good idea."

"I assume it will help, yes, because it puts the onus on the CEO and top management to know what's going on and take personal responsibility for it. It will be a disincentive for the 'cheerleader' type of personality that wants to just push up the stock."

"Honest people won't have any problem complying with the new legislation anyway, and the dishonest ones will still be dishonest. It could make people more conservative on certain issues or decisions that are on the fence."

MOST EFFECTIVE PARTS OF THE NEW REGULATIONS
"I do think we should have had information such as insider transactions sooner. I'd add to that information about loans to company executives, which shouldn't be happening anyway. Any legislation that provides for reporting about that, or even serves to limit the practice, I'm all for it."

"I think that overall it will improve disclosure, including quicker disclosure of quarterly financials. As far as the fraud provisions in the legislation go, all you can say is it's about time."

"The law should make outside Directors more independent and force them to do what they are supposed to do. My major concern would be for the smaller companies that can't afford to pay hefty premiums for broader D&O insurance. I think they will have a harder time attracting qualified people to become Directors."

"I think it will help. Some provisions are more effective than others. Making the CEO personally sign the financial statements is pretty childish, but the increased penalties for people who are caught committing crimes should bring about more justice. Most of these guys just walk away now."

CEO CERTIFICATION NOT EFFECTIVE
"I think it's sad that there is so much distrust out there right now that you're having to sign in blood as it were in order to have your accounts accepted by the investing public. If it makes things more consistent longer term, then it's probably a good idea, even if fundamentally I believe it's a bit of an overreaction."

We don't tend to rely too much on what management says, so the fact that they did or did not sign a certification isn't going to mean anything to me. If you approach the truth as something that I as an analyst have to figure out, well then, none of this *was too much of a shock."*

"I don't think it will have an impact. It's not clear to me that anything has changed and I think a company executive can still claim that he was lied to or that his accountants misrepresented things to him."

"I don't think it will have that big an impact. I see it as mostly symbolic legislation. Congress wants to show voters it is doing something to hold CEOs more accountable. Either you are crooked or you are not crooked."

"Now, as I understand it, the legislation only says that a CEO and CFO must certify their results on the basis of their best understanding and to their best knowledge, which would seem to give them an out. It remains to be seen whether other provisions of the Act, that require CEOs and CFOs to establish systems of control over their accounting and reporting processes, will actually work. We'll see."

"I assume it would be a jury trial that would send a CEO to 20 years in jail. It doesn't look to me like anything has changed even with certifications and some of the things the Act requires. These executives were already ultimately responsible."

"I think it will be minimal. There are a lot of qualifications in the law, so a CEO and a CFO saying that they are certifying their financials is no different really from their results being audited under the former practice. I don't think the legislation by itself will have any impact on improving the quality of reporting."

"I think it's one of those things that won't have a lot of impact because it seems to me that the way things are structured, if people want to do dishonest things, they'll do them."

LEGISLATION CANNOT STOP FRAUD

"I don't think it will help dramatically. I don't think the quality of reporting or the regulations on accounting were that bad to begin with. It comes down to a small minority of executives committing fraud, which they will continue to try to do."

"I don't think legislation will end fraudulent activity. It never seems to stop, so I'm inclined to believe that Sarbanes-Oxley won't stop it either. It may have some effect on raising the quality of reporting standards overall, but will it stop fraud? No."

"I think it's perhaps a slight overreaction. What I think we've seen here among U.S. companies is the result of a few bad apples. But everyone else has been tarnished at least with the suspicion that they're doing something wrong with their accounts."

"The perception of the market was probably that it was worse than it actually is, so in terms of market confidence, I think it helps. But in terms of actually preventing fraud, I don't think the fraud was actually that widespread, so I don't think it will have much of an impact."

APPLICATION TO NON-U.S. COMPANIES

Do you think that the SEC should apply all of the Sarbanes-Oxley requirements to non-U.S. companies, and why or why not?

- There are split opinions on whether the U.S. has the legal or moral right to impose its regulations on non-U.S. companies. About two-thirds of the investors interviewed strongly believe that the new regulations should apply to all companies listed on a U.S. exchange. The other third has reservations.

- Those opposed to the internationalization of the regulations focus primarily on the criminal penalties. They do not think that the U.S. should prosecute foreign executives under U.S. law, and may not have the legal right to do so. Reflecting the greater political debates of the day, some investors suggest that the U.S. should pursue a less unilateral approach to global securities regulation and work through international organizations for a more effective and uniform code.

- The majority that supports application of the new regulations to non-U.S. companies focuses primarily on the reporting and disclosure requirements. As far as these individuals are concerned, any rule that applies to a U.S. listed company should apply to a non-U.S. company as well. It is part of the cost of trading in the U.S.

- The majority does not see the new regulations as being any more onerous for non-U.S. companies than for U.S. ones. As discussed above, most of the requirements are reasonable responses to discourage a repeat of the excesses of the recent past. Some of the criminal aspects of the new regulations may sound draconian, but in practice have little consequence. Overall, the criminal threats are viewed as largely symbolic, redundant with other regulations holding executives responsible and having escape clauses built in to protect all but the truly guilty. Overall, the majority view is that honest companies do not have much to worry about.

FAVOR REGULATION OF ALL LISTED COMPANIES

"If they are registered in the U.S., of course."

"Absolutely. If you are a non-U.S. company it's part of the conditions for being listed on the NYSE or on NASDAQ."

"I think that if they are listed here, and they're capable of raising funds from U.S. investors in a secondary offering, then I would certainly think they would be required to comply with the new rules. If these are the rules, they should apply equitably."

"If they are listed in the U.S., yes."

"I think this is a straightforward issue for companies listed on U.S. stock exchanges. If you want to sell stock here, you have to comply with our securities laws. I don't think it should apply to foreign companies that are simply doing business here."

"They should apply to non-U.S. companies that are listed on U.S. stock exchanges. I would include the Level 1 ADR programs for the companies that are listed on the Pink Sheets."

"Anything that is required for listing on the NASDAQ or NYSE should apply to any

company. It should apply to non-U.S. companies no differently than U.S. companies. I don't see why there should be a difference."

"Again I go back to using this word 'consistent.' I think that if companies are going to be quoted here on the Big Board in New York, then they ought to be able to meet the same standards."

"For companies that are listed in the U.S. and report in U.S. GAAP, it's only fair. I've heard the argument to the contrary, but if a company has gone through the trouble of putting together a set of GAAP accounting and has listed here, it should stand by its accounts. I don't have an issue with it but it might require extra effort."

"If you want to list your equity in the United States, you have to play by our rules. If you don't want to obey the securities laws, then don't list here."

"I'd like to see them applied to non-U.S. companies. There is still a lot of difference between the European companies and the U.S. and a global standard would be the best case for everyone, especially those doing global investing. I don't know how committed some of these other countries would be to something like that and how they would come about doing it, but it would be welcome."

"I don't know what the cut off should be, but if an international company has a listing on the U.S. markets, an ADR or a significant debt offering or has a significant percentage of its ownership based in the U.S., then yes."

"I think those companies that want to be listed here - I don't know whether the SEC should - but I think that all companies that want any kind of shareholder following in the U.S. are going to have to do it."

NON-U.S. COMPANIES SHOULD BE TREATED DIFFERENTLY

"I don't. It seems to me we would be forcing some pretty draconian measures on foreign issuers. I have mixed feelings about applying the rules to non-U.S. companies who are listed here. I would prefer if the Exchange set those kinds of regulations rather than the U.S. government. It seems like the U.S. government is forcing some pretty strong measures on foreign issuers. I would rather it be an Exchange requirement."

"I think the way it was drafted was done poorly for these companies, many of whom have found out in the fine print of Sarbanes-Oxley that, by not having certified their second quarter numbers, they broke the law. So, we've criminalized many companies that have an ADR, even if it may not have been clear to them that they had to do this."

"They can't really because they cannot enforce, for example, jail penalties for overseas executives. They might try to impose the responsibility. I don't know that they can enforce it."

"To be honest, I don't think the U.S. has any rights or jurisdiction over non-U.S. companies, unless there are U.S. operations or headquarters. Even then, if the SEC were to go after them for non-compliance or even abuses, they'd likely de-list. That becomes a NYSE problem. I just don't think the U.S. government has the right to sue a foreign company. Perhaps it would be helpful if they could get this passed through some accepted international body such as the WTO."

"I don't like it. I think it will invite retaliation from the EU countries and a war over corporate governance rules between countries would not be good for the markets. The EU has its own set of rules and I don't think they are necessarily more lax than the U.S. rules, just somewhat different."

"I would say no. I just don't think this type of legislation can be applied to the broad-based international market. It will only make a confusing situation worse. There is no single international market. There are 30 different tax systems and at least two different general styles of accounting disclosure."

"I haven't thought about this and I really don't know the arguments but we would have no European companies listed on our Exchanges if the rules are too strict. It might be a good idea, but I think it would be too difficult to implement."

"Surely the U.S. can't tell the non-U.S. companies what to do. These companies operate under their own laws and corporate governance procedures. It is our job to understand them and factor in the risks of investment into our analysis. But we can't make them act like U.S. companies."

EXCEPTIONS FOR NON-US COMPANIES

What, if any, exceptions should be made for non-U.S. companies?

- As discussed earlier, the majority of investors believe that there should be no exceptions. Among the minority who think that there should be exceptions, there is no consensus on what specific parts of the new regulations should be excluded.

- Some interviewees advocate only giving non-U.S. companies more time to study the new regulations. The companies could then make a reasoned decision about whether to comply or delist. The legislation's haste may have unfairly forced some non-U.S. companies into criminal non-compliance, perhaps unintentionally.

- Others say that the new rules should apply only to actively traded and listed stocks. Exceptions should be given to illiquid securities and those that are private placements.

- One investor says that the disgorgement of executive gains following accounting restatements cannot be practically enforced by the U.S. and that such matters should be left to home market regulators.

NO EXCEPTIONS

"If a non-U.S. company is listed on the NYSE, I don't see any good reason why they can't comply with the standard regulations and laws that apply there. In the case of German companies, for example, that have recently asked for relief from the provision about reporting loans to company executives. I see no good reason for such exceptions. Companies that want to list here should comply."

"I don't think they will make an exception. What I think will happen is they'll get into a situation where they need to enforce and they won't be able to. I followed a non-U.S. phone company listed on the NYSE and outright fraud was committed. You didn't need a lot of analysis to understand there was something funny going on. The company went bankrupt and who at the SEC is going to enforce anything in an emerging market? It's impossible. All the SEC could do is initiate legal proceedings in the U.S. which will prevent executives from coming to the U.S."

"If a company wants to list on NYSE, it has to abide by the NYSE's rules of trade. So, this could be considered just one more set of rules that apply if you want access to capital in the U.S. market, the cost of doing business in other words."

"If the overseas companies do not want to comply to the letter of our law, it will eventually keep people from buying their stocks."

"I don't think you can say that just because you're a foreign company, the new rules don't apply to us. I mean, nice try, but if you come here you have to abide by the rules of the U.S. trading system whether you like them or not."

"None. They have to have the same requirements as any company that is in the U.S."

"No exceptions. Companies shouldn't be able to dictate which regulations they will follow and which ones they won't."

ALLOW MORE TIME TO COMPLY

"I think they should be allowed a window to decide whether or not they wish to continue with an ADR, without being criminalized

for that. But I don't think they should get any special dispensation other than that window."

"I don't see why there should be any exceptions for non-U.S. companies. Perhaps they should get a longer time to get themselves into compliance."

EXCEPTIONS FOR NON-ACTIVELY TRADED SHARES

"If a company has a full U.S. listing, there should be no exceptions. You might consider exceptions for companies that do private placements under rule 144(a) because their stocks don't really trade here."

"Non-U.S. companies listed here and actively trading should have the same type of regulation as major U.S. companies. There are many smaller non-U.S. firms whose stocks trade with less liquidity. I suppose I could see making some exceptions for them on a practical basis."

BOARD MATTERS

"This is a tough one. You can see both sides of the argument. I guess I believe they should allow some exceptions. Our government's control should not extend into the Boardrooms of foreign firms. That's none of our business. But we should require them to have accurate financial statements."

CURRENT REGULATIONS SUFFICIENT

"If a foreign company lists in the U.S., more than likely they already have to file a 20-F reconciling their accounting system with the U.S. And that shows all the differences. Take Ahold, for instance; when they filed the statements in the U.S., there were all these income items that were not discussed in their Dutch press release and financial statements, but which came to the light of day under U.S. GAAP. It's all there. There's nothing else they had to sign. All the information gets translated into U.S. GAAP, and I think that's good enough."

DISGORGEMENT

"Certification doesn't seem like a big deal, job protection for whistleblowers doesn't seem like a big deal. Forcing executives to repay bonuses in certain instances DOES seem like a big deal. I doubt that a UK or German company would submit to that. I would say that companies should be given leeway on many of those measures according to home country practice."

IMPACT ON LISTING IN THE U.S.

Do you think fewer non-U.S. companies will list their shares in the U.S. as a result of the new legislation?

- Few investors expect that the new regulations will lead many currently listed non-U.S. companies to actually de-list from a U.S. exchange. Again, the view is that for honest companies with nothing to hide the new regulations are not particularly onerous. They may be an annoyance, but not enough to lead to a delisting.

- In this context, there would likely be a stigma attached to companies that do decide to de-list. Investors would be suspicious of why the company felt it could not comply with the new regulations. The implication would be that the company has something to hide, which would likely affect its access to capital in general.

- About half the interviewees are concerned that the tough new regulations may discourage new companies from seeking a U.S. listing. This would be a disappointment for certain funds that cannot invest in unlisted non-U.S. shares. Without a listed ADR available, they would not be able to invest in such companies. Even institutions that do have the capability to trade the ordinary shares feel more comfortable investing in a non-US company that has a listed ADR program. What they like the most is the full 20-F disclosure that results.

WILL NOT REDUCE LISTINGS
"I would hope not. If companies refused to list in the U.S. because of the legislation, it would change my view. For most of our assets, we can only invest in international companies that are listed in the U.S., so it would make a pretty clear difference to us."

"No. If a company wants to expand in the U.S., they will need a U.S. stock listing. I would have a negative view if they decided not to list because of this and would wonder what they have to hide. If they are confident in their accounting, they wouldn't mind signing."

"No I don't. My guess is that they will need American capital and will continue to want access to it. If these are the rules, they'll follow them. And if they're running above board, it won't be that big an obstacle to comply."

"I don't think so. It is still a $10 trillion market. The thing is, the U.S. can do anything it wants, but at what impact? What effects are we looking at 20 years down the line if we begin acting so unilaterally now? Does another market, like China, win the competitive advantage and become the better place to list because we put up so many roadblocks here in the U.S.?"

"There will always be a handful who will want to play by their own rules. But I think most will stay listed and comply. If you are innocent, why not?"

"I don't think so. People who want to list here will just do it. If they are crooks, they are crooks here or anyplace."

"There are always issues about listing in the U.S. having to do with liquidity and filing a 20-F. I think that's probably more of a hindrance than actually signing off on those statements. So I think the barrier would not be raised significantly, no."

"For those who haven't listed, it could delay the decision to list. For those who are already listed, I haven't heard anyone say they might want to de-list."

WILL REDUCE NEW LISTINGS

"My fear is that it's going to make many companies unwilling to come to the U.S. to get a quote on the Big Board. We have encouraged companies like Nestle for a long time to move away from having a pink sheet-traded ADR to getting a full quote and they've been reluctant to do that. And I think this will make them even more reluctant in the future."

"I think the unilateral nature of this regulation does undermine the SEC's attempt to have the U.S. be seen as a global trading center if, by global, you mean having as many stocks traded here as possible. I think it will discourage that view."

"That might be the case. I will never know that is the reason they are not listing. Companies would have so many reasons for not listing since it really is a voluntary step that involves a lot of costs. It will only pay off in sectors that are followed and understood and where they think they can create an investor following and lower the cost of capital."

"It has to have an impact. I think companies that aren't listed now will wait a while to see how the new regulations will impact the companies that are already listed."

"I think we will see fewer companies who don't list their shares now listing shares. I think it will definitely cause these firms to delay their listings until they determine the possible impact on their accounting practices. I can't say whether it will encourage any listed companies to de-list."

MAY CAUSE DE-LISTING

"I think German companies will definitely think twice about listing and those who are already here could quite readily de-list. I think the German companies feel particularly burdened by this legislation. In any event, the Germans and the French are never completely accepting of U.S. positions on things. The UK would probably be closer to assimilating, as would the Canadians. The Japanese won't be very happy."

"This is forcing companies to a very high standard to list which I don't think is necessary. I'd expect fewer companies to list and it wouldn't surprise me if we see some de-listings."

NEGATIVE IMPACT OF DE-LISTING

"Possibly, though I doubt any company would publicly say that that's the reason they are not listing on the NYSE. If a company said they were not listing on a particular exchange because they refused to comply with the conventions of that market, and the applicable disclosure laws, and because they don't want to disclose relevant information, then yes, I would have an adverse opinion of that company."

"I think that over the medium term this will have very little effect on the desirability of listing in the U.S. market. If a company did de-list, I'd ask myself what they had to hide. It's an administrative burden to have gone through it once and I can understand the reluctance. But to have examined the issue fully and then decide to pull out, I just think, well, what is there that you're not willing to sign off on?"

"It's possible. It's just an extra hurdle, an extra hoop, although if it is a disincentive to be responsible for your own reporting, that doesn't reflect very positively on management."

In light of the recent accounting scandals in the U.S., how has your view changed regarding the strengths and weaknesses of U.S. GAAP vs. UK GAAP or International Accounting Standards?

• About half of the investors interviewed do not see the recent accounting scandals as being an indictment of U.S. accounting principles vs UK GAAP or IAS. They view the scandals as the result of criminal behavior in a frenzied market. The accounting standards were not to blame. It was the fault of the managers, accountants and investors who abused or neglected the standards and controls that were in place. Under the same circumstances, neither UK GAAP nor IAS would have made much difference.

• Most of the other half say that the scandals exposed serious flaws in U.S. GAAP that need to be fixed. Among the chief problems in need of repair are the rules on revenue recognition and off balance sheet activities. These were two of the areas of greatest abuse in the recent scandals. The rules were obviously too flexible and need to be tightened.

• A number of investors comment that these flaws and the way they were abused have shaken their confidence that U.S. standards had been the highest in the world. They are shocked at how extensively they were violated. They no longer see U.S. GAAP as the model to which others should aspire. The U.S. needs to learn and adapt from other systems.

• Only a few, however, got so far as to say that U.S. GAAP should be abandoned all together. Those who did say that think the problem with U.S. GAAP is a fundamental one. It is based on a proliferation of detailed rules rather than broad principles. In a bull market with extravagant incentive compensation packages, this system encourages competitive managers to view the rules as a sort of game they have been challenged to win. They will push the rules to the limit with little sense of responsibility for adhering to the ethical principles behind the rules. UK GAAP and IAS, on the other hand, are based on broad principles and would avoid that kind of rules skirting.

• Others are resistant to the idea of switching from U.S. GAAP entirely. They say that despite the flaws that have been exposed, U.S. GAAP still provides the most detailed disclosure of any of the systems. It provides good analysts with more of the information they need to come to their own conclusions about a company's financial condition.

CHANGING FROM U.S. GAAP WON'T HELP

"It is not a problem with accounting principles. It is a problem with enforcement. There are some bad people out there who want to get rich, illegally if necessary, and some highly paid advisors who are willing to help them."

"No. I don't think any of them are perfect. I think fraud could happen. I think scandals happened because there was a frenzy going on in the market and companies saw a clear opportunity to benefit and they disregarded the risk. They saw no risk."

"I think any accounting standard has wiggle room in it and that wiggling has been going on for a long time. So I don't

think the fraud was due to U.S. GAAP. It was more people ignoring U.S. GAAP and going around it. So I think U.S. GAAP is fine, I think IAS is fine as well. U.S. GAAP is probably better. There are slight differences in UK GAAP but if you adjust for them, they are relatively the same. The problem I have with International is they are only required to report every half, but that's not U.S. GAAP, that's just their regulations. I would rather see them reporting quarterly and doing full financial statements, not just the P&L."

"Not really. In my view, it's more to do with executives who want to play games and accountants who want to play footsie with them."

"I think there isn't as much transparency in U.S. GAAP as we thought, but some of the fraud had nothing to do with U.S. standards or any other standards. If you have smart people that want to cheat you, they will. If they push a little on the accounting relationship to steal, and some were actually stealing directly from the company itself, then that's not a weakness in the accounting laws. Any first-year accounting student will tell you that. I mean, is speeding due to weaknesses in the traffic laws?"

"No change. I've been more fully trained in U.S. GAAP and I'm more comfortable with it and I prefer U.S. GAAP."

"U.S. GAAP is still best in terms of disclosure. Basically you have two different types of disclosure in the world. You have the British/American way, and the German/Japanese way. One is based on hiding income from tax collectors (the German method), and the other is to increase income to shareholders (the American/or Anglo Saxon way). Both systems have good points. The U.S. method has more disclosure. The German way is more conservative."

"You can take things from both, but I'd rather have more disclosure as we do here in the U.S. and let me as an analyst dig in and decide what assessments have to be made to bring the company statements into economic reality. If anyone took the time to look at Enron's cash flow statement and their income statement and balance sheet they would have seen something. There were plenty of red flags."

"I don't see one standard as superior to another. They are all fairly similar regarding basic accounting standards. You just need to study the systems to see what the differences are and understand them."

"The way we manage money is that we make adjustments to the accounts of the foreign companies we look at. And in doing that we use a couple of U.S. accounting standards, specifically the treatment of good will and depreciation. We believe some of those things are clearly important, just to try and get an apples-to-apples comparison."

"It doesn't matter what accounting principles you follow if there is no enforcement. I think some of the companies from smaller countries in Europe are naturally more honest because they have more social and cultural pressures on them. They have to live long-term in relatively closed investment communities. In the U.S., where everything is wide open and companies are allowed to push the limits, there have not been enough consequences to discourage them. Maybe we are now seeing a cultural shift that will change the standards for performance."

"That's a tough question. I think there are some issues that need to be tightened in the U.S. standards. Obviously one is the massive abuses of revenue recognition that can take place, as well as expense capitalization and capitalization of R&D. In general, I'd say I'm dissatisfied with all the abuses of the matching principle of revenue and expense. Off balance sheet transactions are another issue. Of course, that's where a lot of the fraud occurs and I don't think we'll stop it with legislation."

U.S. GAAP SHOULD BE RECONSIDERED
"Yes. I guess the way that U.S. GAAP is structured, it results in companies playing games to see how far they can push the rules as opposed to IAS being focused on intent. It remains to be seen."

"I must say that my overall view of the U.S. accounting system has changed. I always had the perception that the developing market world had less stringent standards of ethical procedure and that it was much weaker in this sort of thing than the developed world. But I don't believe that any longer. I think there is more dishonesty in the U.S. than elsewhere, particularly in larger companies. There's more incentive to cheat, the gains are higher, particularly in the area of management compensation. That's a whole area replete with abuse in the U.S. and frankly, I've been shocked by the extent of it."

"I would say yes. U.S. GAAP is not as bulletproof as we thought it might have been and it's probably not the world's standard that everything else ought to follow."

"U.S. GAAP is held up to overseas companies as whiter than white and as the be-all and end-all of accounting standards. Foreign companies are told that if you're not up to these standards then you're not up to the highest standards, and it's just become pretty clear that you can drive a bus through U.S. accounting standards."

"Nobody seemed to mind the bending of rules in a bull market. But in a bear market, I think the U.S. standard has been shown to be particularly creaky, as accountants have been reluctant to allow accounts to be published in as straightforward a way as possible. To call something a standard, it needs to be a standard, for every company and regardless of the market atmosphere. It's pretty clear that U.S. GAAP has been undermined as an accounting standard because of all of this and I don't see any way that you're likely to find overseas companies buying into the U.S. standard and applying it consistently if they don't have to."

"Yes, my view has changed. The U.S. was considered more transparent and stricter in disclosure, and now I think it was just a lot more rules and not necessarily better quality."

"International Accounting Standards are probably better than the other country-specific systems. Changing over to IAS would be a positive, especially for investors. It would make our job so much easier."

"It depends which international country you're comparing it to. I think vs. UK GAAP, the UK has done a better job at allowing less loopholes. But if you look at France and Spain and Germany, I think the U.S. is still far ahead. I do think the U.S. needs to make a lot more changes, especially with options and come up with some standards where people have less opportunity to play with the numbers."

"Yes, I guess I am more skeptical about U.S. GAAP."

"I guess this has probably made U.S. GAAP seem less of an advantage than IAS or UK GAAP."

"The U.S. has always acted like U.S. GAAP is the best way, but after seeing what happened and viewing companies globally, I think we are not any better. Different accounting systems are just a different way of looking at things. Where there are differences between systems, they are in areas where it is difficult to find a right answer or where there is no right answer, like treatment of goodwill and what qualifies as off-balance-sheet items."

Are the kind of problems that arose in recent U.S. accounting scandals less likely to happen under UK GAAP or IAS, and why or why not?

- When asked directly whether UK GAAP or IAS would have prevented the recent accounting scandals, the mix was the same as in the previous open-ended question. Only 4 of the 22 respondents say that U.S. GAAP itself was at fault and that the U.S. should consider moving to a system more similar to UK GAAP or IAS.

- Some of those who advocate a switch to IAS view its primary advantage to be the establishment of common accounting standards around the world. They are more concerned with uniformity than with the relative merits of the systems. They view the blow to U.S. GAAP recently as beneficial in opening the minds of U.S. regulators and investors to considering a switch to IAS more seriously.

- The majority repeat their view that no accounting standards could have prevented the outright cases of fraud that have received such high visibility. The real culprits are careless or negligent boards of directors, complacent auditors and lazy analysts. They let the system down more than the system let them down. In the tech boom, the thirst for extraordinary gains drove a CEO star culture and inflated compensation systems that proved to be a disastrous combination. The people responsible for watching and controlling this system failed in their responsibilities.

DIFFERENT SYSTEMS WOULD NOT HAVE HELPED

"I don't think it is a function of one accounting system being better than another. It is a matter of oversight and enforcement at the board of directors level. We wouldn't need more SEC rules if directors were enforcing the ones that already are in place."

"Again, I don't know if that was the cause. I think a lot of it was incentive based as opposed to what the accounting rules were. Greed exists under any accounting standard. And the incentive to cut corners, cheat, whatever you want to call it, was greater based on valuations in the U.S. market and incentives for U.S. management. I think there were stronger stock incentives than in other markets. That was really the cause."

"I'm not sure about that, and I don't think that's the issue. I think the big debate ought to be the subject of why this happened in the U.S. I think perhaps that it comes down to greater incentives and the pressure of meeting quarterly targets for results. I also think that the people who are all over the press right now are just people who have been more willing to bend the rules than perhaps would be the case in the UK."

"The incentives for driving up the stock price are not as intense there as they are here. Our problems are traceable to the system of reward and compensation and the guilt applies to investors, the media and corporations themselves. We've all bought in to this. There is much culpability attributable to compensation that is a function of driving the share price. If you're in a culture like Japan or parts of Europe where driving the share price isn't as advanced as it is here, I don't think you see the same level of abuse."

"I'm not sure it's so much the accounting as the supervisory boards and the structure of boards having fewer insiders. Maybe I am generalizing here but I believe that European companies tend to have either fewer insiders or a broader representation on the board and have supervisory boards that might prevent the type of manipulation that you've seen here."

"IAS has loopholes just like U.S. GAAP does and it's really ironic to see German companies trumpeting the virtues of IAS now. I think we will see less of a tendency to take advantage of the loopholes going forward under any standard, which is a good thing. Recent events have perhaps elevated IAS, but U.S. GAAP is still better from my perspective."

"The CEO star culture never developed there to the extent we have it here, so I'm not sure it's just accounting standards. I assume if we had IAS, you probably would have seen the same kind of behavior, they just would have found another way of doing it."

"No. Human nature will find loopholes. The perceived advantage in people's view that this couldn't happen under U.S. GAAP has now been taken away."

"I think those who want to cheat would do so under any standard and many analysts are just too lazy to try and figure it out."

"We've had cases of fraud in the UK in the past. It's been evident that we've seen fraud on the Continent too. Their standards aren't necessarily fool proof. Brilliant accountants and lawyers will always figure ways to get around any standard. We'll never stop fraud."

"Europe is a big block, made up of many different countries, so it's hard to say. They still try to hide things in Germany, though over the past 5 years they've opened up."

"Accounting standards are not going to totally prevent fraud. A body of accounting standards cannot encompass every imaginable transaction."

"I don't know about that because the scandals were motivated by greed and a willingness to take chances pushing the limits of the system. If we are talking about ordinary, day-to-day accounting practice, IAS would be better simply because it would create a common international standard and practice and we wouldn't have to worry about treating differently companies differently."

"There will be corporate fraud no matter what the accounting standard is. I think the UK and IAS standards would be less abusive of stock options, so that's one area. Some acquisitions I think would not have happened under UK GAAP vs. U.S. GAAP."

"No, I don't think so. Is it the accounting that's causing the problems? Probably not."

"It has nothing to do with GAAP or IAS. It has to do with people. That is why you buy based on management. Any story you buy is pretty much a management story."

"If the accounting systems were followed to the letter of the law, there probably wouldn't be major problems under any of these systems. The problems come up when the companies try to take the most liberal interpretation of what they are allowed to do. A few companies would rather not work within the bounds of "generally accepted" practice, although I think they are in the minority."

U.S. GAAP NEEDS TO BE REPLACED
"All three accounting systems are fairly robust, but I would like to see the entire system changed over to IAS. Go to one standard. It would make our jobs as investors and analysts much easier if all companies were on one accounting standard, and it would probably be good for the stock markets as well."

"I think the world will eventually go to IAS. With the U.S. legislature now willing to admit our laws were inadequate, I think you will see less of a U.S.-centered view and more open-mindedness about an international standard. That would solve the problem of the U.S. seeming to impose its laws on companies from other countries."

"I do think they're less likely under the UK or International Standards, yes."

"It's less likely on a principles-based system such as is in effect in the UK. In the U.S., we had a combination of incentive compensation plus very voluminous disclosure rules, which creates loopholes and incentives to exploit them."

How do you regard continental European companies generally in terms of the effectiveness of their communications with investors?

- The accounting scandals have heightened U.S. investor demands for timely and thorough disclosure from all companies. In the case of continental European companies, U.S. investors say that their disclosure and communications have improved significantly in recent years, but still have a way to go.

- The most noticeable improvements are a new openness in talking about the company's operations and strategies for growth. In the past, European companies tended to be fairly secretive about these matters. When they did disclose much information it was often in vague generalities with no quantification. This was a disappointment to numbers-oriented analysts.

- Today, a number of leading companies from across Europe are much more forthcoming. They are more willing to discuss their plans and outlook. More often than in the past, they are willing to cite numbers to illustrate their points. They now have professional investor relations departments that make a pro-active effort to keep investors informed. Respondents say that this is a remarkable contrast to only a few years ago when many European companies were very unresponsive to their inquiries.

- Access to top management has also improved significantly. Senior managers make the effort to visit the major U.S. investment centers to have discussions with international fund managers. The fund managers say that these face-to-face meetings are essential to developing personal confidence in investing in a company. Especially in light of the recent accounting scandals, investing in a company is investing in the quality of management.

- Despite these much-appreciated improvements, most of the U.S. investors say that there is still a long way to go for most European companies to achieve adequate disclosure practices. There is often a large gap between the few leaders in a given country and the large number of other companies that adhere to traditional low-disclosure cultures.

IMPROVED IN RECENT YEARS
"For the most part they've come a long way. They used to be very secretive, but when they began to need capital in the U.S., that opened them to new rules and they have been adjusting to the demands of that."

"I think they have improved over the last couple of years, but they are still leagues behind U.S. and UK companies in terms of communicating."

"It's getting better, even if it's still not quite as good as it could be. We've certainly found that there are lots of companies who we're involved with, or would like to be involved with, who have been much more willing to meet investors, and be open about what's going on. They've become more willing to spend time in the U.S. as they build up a shareholder base."

"I view it as improving but not perfect. It's not where I want it to be. It's getting better, even if it's still not quite as good as it could be."

"They're getting there. It still depends on where in Europe you're looking."

"I think it's quite good actually and a big improvement over a year or two ago. They are getting around on a more regular basis. So if you are in New York, I don't think it is a problem in terms of access at all. In many ways, I think it's better than some of the bigger U.S. names."

"I deal with consumer companies and the communications are OK. It's spotty. It is improving, I will say that, definitely improving."

"I would rate it very high and over the last five years, I've seen a huge improvement."

"It varies widely. Overall, it is not as good, but it is getting better."

"They are getting better but have a good deal to go and could make lots of improvements."

"They are getting better and better at it."

"The ones that do a good job are here more often."

"You have to take time to understand what they are doing. They are not as open as U.S. companies. But that is why we have specialists in non-U.S. equities, to take the time necessary to find the best investments."

STILL PROBLEMS
"It's really mixed. Many companies think investors are simply a bothersome group of people. Because these companies have always relied on the debt markets, not the equity markets and they think they are doing a favor to investors to offer a piece of their ownership."

"Certainly Continental companies could make things clearer in their reporting and disclosure. Opening themselves to more disclosure would be welcome, since their disclosure standards are notably lower than UK or U.S. companies', or Japanese companies' as a matter of fact. Actually, I'd like to see a melding of international standards. That would help me as a global investor. It could be done from the financial accounting perspective if not the tax accounting side. I do understand the wide variance in tax laws among countries."

"It is all over the map. Most companies are extremely average, with a few being very poor and a few giving investors what they want."

U.S. NO BETTER
"It depends on the company. Some are very good and some poor. Some are enthusiastic and some cautious. Overall, the quality is no different, even if non-U.S. companies tend to be relatively more conservative than U.S. firms."

"I cover mostly the Nordic companies and the U.K. and I trust them more than I trust the majority of U.S. companies. The U.S. companies have so many one-time events, and write-offs and restatements it is hard to decipher what they are doing from one reporting period to the next."

INVESTOR RELATIONS QUALITY BY COUNTRY

If you consider disclosure and transparency, which continental European countries are best/worst?

- Investors say that in every country there are examples of companies that are very good at investor communications disclosure and ones that are very poor. Nonetheless, there continue to be distinct local business cultures that create noticeable national patterns to disclosure practices.

- The UK is the clear leader in providing adequate disclosure and transparency, followed by the Netherlands. Mostly, however, these countries have had adequate disclosure for years. The relative improvement has not been a big factor.

- The most-improved disclosure, according to a number of investors, has been among certain French companies. They had been among the most secretive a few years ago and have made an effort to be more forthcoming in the past few years.

- Germany receives the most comments, both good and bad. Some investors point to a handful of German companies that have adopted more of an Anglo/American policy toward open communications with investors. Many investors, however, criticize the bulk of German companies that have resisted these changes and continue to treat shareholders with indifference.

- Investors cite Italy and Spain as among the countries where disclosure standards have traditionally been low and continue to be so.

"International Accounting Standards are a major improvement. They have actual investor relations departments now and they are trying to have people answer your questions and the information they provide is better. They try to tell you what their business is about. They release sales or revenue figures on different segments and divisions, which they didn't do in the past. They also give you answers to your questions with a real number attached. That wasn't the case formerly."

"The UK has always been the best and is like the U.S. But I've seen phenomenal improvement on the part of French companies. That's the most improved category. The least improved are the Dutch, although they were not as bad to begin with. Iberian peninsula companies - I think they have gotten much better as well. Ireland has always been very good. Germany has also improved a lot but it's still not as good as the French."

"The UK is up there with the best. European companies will disclose information, but they're still willing to use things like discretionary reserves, accelerated depreciation, that make their numbers a bit less comparable. Italian companies are known perhaps as being less open than they ought to be."

"The UK is the best. Typically I stay away from the ones that don't talk. Germany and France are a bit more difficult."

"Germans tend to be not as good, but they are trying hard and getting better. Everybody is getting better. The French and the Germans are the biggest part of EAFE. They are not yet up there in terms of disclosure but they are learning, they are getting there."

INVESTOR RELATIONS QUALITY BY COUNTRY

"I just think the problem in Continental Europe is that companies are under political influence that hinders their being freely traded. I think the French example right now is Vivendi, which is selling its businesses and the French politicians are saying you can only sell your French education business to another French investor. That's a political battle that I hope we will see an end to."

"I'd rank the UK at the top. The standards are principles-based, and the corporate governance is the strongest in the world in the UK. There's none of this tolerance of a joint CEO and Chairman of the Board structure that we have here. There's no tolerance for a board consisting of insiders and some of the garbage you see in America."

"In Italy the governance and disclosure go hand-in-hand. You have small shareholders having an outsized voice on the board, running the company as their own family business and no shareholder rights. Your ability as a de facto minority shareholder or minority shareholder is very limited. Disclosure is whatever the companies want to do. I would put Italy at the bottom. Somewhere in the middle, I'd put the Swiss. The Swiss do a reasonably good job and have made some progress with better disclosure but it could just go further."

"Germany is still down at the bottom of the list and the UK is near the top."

"I'd say Germany, France have improved. Obviously, Italy and Spain are further behind those two. I think the Netherlands is probably the most open because a lot of them are U.S. listed. Nordic companies are OK - not great - but a little better than France and Germany. Italy and Spain are by far the worst among the big markets."

"I actually have found Dutch, British and Swiss companies to be pretty good on disclosure and meeting with investors. French and German companies less so."

"I still have problems in Germany with provisioning. My companies in France are OK. Germany, Austria, those would be two I'd highlight as more opaque in terms of disclosure. I only follow one Italian company - a big oil company - and they are listed and have great disclosure."

"If you are looking for bad actors, the small German companies are the worst. They still confuse following the rules with bending the rules to put on a good face. Then I would list France, Italy and Spain as being behind the others."

"Germany is especially bad. Italy is horrible. France is getting better. The UK is as good as it gets. The Scandinavian countries are pretty good because they really do have a heritage of financing themselves in the markets. The Continental European companies have used debt more than anything else. My experience with Iberian companies has been good, but I think it is very limited. A company I used to follow doesn't exist anymore, but they haven't been bad in disclosure."

"There are some French companies that are starting to do better. I think some of the more international German companies have gotten fairly good."

"That's hard to say. Perhaps you could generalize and say that the UK is more conservative than other countries, but in this context, it's meaningless, since there have been scandals everywhere."

"Disclosure is sometimes lacking in France

and Germany, where they have a lot of the off balance sheet kind of thing. I don't like Dutch accounting for goodwill, which has historically been written off. I don't like the UK standard of writing off goodwill either."

"Insurance companies are difficult to understand no matter where they are domiciled, but the financials of insurance companies in Europe are easier to understand than the insurance companies based in the U.S."

"As a generalisation, the southern and eastern European countries are not as good as the western European countries, with exceptions in all regions."

"The UK is pretty high up there on my list. In Spain, I only have one company and their disclosure is absolutely horrible so I have a little bias there. Most of my companies on a global basis are in the UK and the ones I follow are doing a really good job."

"The UK is the best, probably because of similarity in accounting and language more than anything else. Then, the further you get away from the U.S., there is almost a direct correlation with how well they communicate."

"All the companies are becoming more aware of the demands by investors for more disclosure. Analysts are alerted to the differences between countries and the companies that are not doing a good job will be differentiated."

What are the main improvements in disclosure practices continental European companies should adopt?

- In the post-scandal environment, the key demand from investors is for more transparency. More than regulation, more than new accounting standards, what they really want is more detail behind the numbers. Exposure to the light of day is the best defense against deception or fraud. It is also the only way to ensure rational analysis of a company's performance and prospects.

- Topping the list of where European companies need to shed more light are segment reporting and the details behind provisions and reserves. On segment reporting, the issue is mainly analytical. Investors cannot begin to understand a company's performance and prospects given only a single set of financials for the whole company, limited geographic breakouts or only a couple of large business segments. Proper analysis requires understanding discrete business units and that requires data on sales, earnings, return on capital and cash flow. Too many European companies are reluctant to share this information and it is an enormous frustration to U.S. analysts trying to decide whether or not to invest in a company.

- On provisions and reserves, the issue is both analytical and ethical. U.S. investors are suspicious that some European companies abuse provisions as a way to hide or smooth earnings. These practices may help minimize taxes but they also can deceive investors as to true underlying performance. Investors describe this as a major problem with investing in European companies. If there is nothing to hide, the companies should be willing to provide the details behind provisions regularly.

- Along the same line but receiving somewhat fewer mentions are calls for more detailed lines on the income statement and balance sheet and more timely reporting. On the issue of timely reporting, investors are particularly critical of the practice of announcing very sketchy results at one point in time and then taking several months to release the details.

MORE SEGMENT DATA

"The thing most European companies fall down on is the breakdown of their businesses by division. The sales, the profitability, and more than anything else, they never give you enough information about their cash flows."

"They have to show where they have their gains and loses like any other company. It's variable on how deep they go and whether they show every sector of the company or just lump everything together and give a number. Disclosing segments is the way to show what is doing well and what is not doing well."

"Besides quarterly reporting, more information by division. Profitability and ROC by division helps."

"Some companies only report geographically. Shareholders deserve to know what the performances of a company's different business segments are, which is why we require line-of-business reporting in the U.S."

"More comparisons of divisional profits and sales and more disclosure at the business unit level. Companies that provide data on a geographical basis are particularly bad at giving out detail that is useful in understanding their businesses."

"I want full segment data including assets and profitability by segment. And for large companies, use several segments and not just two."

"Every company should report quarterly and within a few months, even German reinsurance companies."

"They already have instituted IAS. That should take care of most big issues. But they still need to provide better segment data."

MORE TRANSPARENCY ON PROVISIONS AND RESERVES

"I'd like to see more disclosure on reserves. They tend to want to smooth out their earnings on the Continent and they use reserves a lot more to do so. The 'Extraordinary Provision' is an accounting item they abuse. That's a major issue."

"Each country has practices that could be improved or eliminated. For example, in the Netherlands you won't get any detail about operating expenses or provisions. The Germans do this also. They take a lot of provisions to lower and smooth out their incomes, and then they don't provide enough detail. The Dutch do a lot of gain on sales provisions, which can be confusing."

"I would like to see reserves for long-term projects disclosed. Insurance companies should disclose a risk analysis of their bond portfolios. Prudential recently made such disclosures about the quality of their bond investments."

"I would like to see much, much less use of provisioning and better explanation in the notes of why provisions are taken."

MORE DETAILED STATEMENTS

"We always like to see more detailed financial statements from European companies. A few specifics would include more detail about gross margins, and margins broken out separately. Also, European balance sheet accounts are not generally very detailed in nature. That could be improved."

"I would just segment the market into those that do a good job of giving supplemental data and those that give the classic three-line income statement that never really changed. In many cases you have virtually no detail in an enormous organization. You have no idea what's going on underneath the surface in any sort of thoughtful way."

MORE TIMELY REPORTING

"They put out preliminary reports and then the final six months later. If you have a preliminary statement done, why not take a few more steps and just do the final one."

"Adopt a consistent set of disclosure standards, like putting out a full balance sheet and income statement and a cash flow statement and an EPS calculation every time the company reports, whether that is every six months or three months. The French report their sales numbers on time and then it takes them three months to finish their audit and provide the details. Why do the French authorities let them get away with that?"

"Companies are also very tardy about

putting their financials on their Web sites in English within a reasonable amount of time and putting their Annual Reports up before they are six months into the next year and it doesn't mean anything anymore."

"I can't believe the bigger companies still report on a semi-annual basis. They have the manpower to report more often. With smaller firms, the six-month cycle is more understandable. In the interest of investors having the information they need to make fair and informed decisions, I would like to see all companies report quarterly."

"It would be nice if they reported on a quarterly basis."

DEBT INFORMATION

"I would like to get debt maturity and debt covenant information. It's hard to get. They don't want to give it out, because they really don't want you to know."

"Pay more attention to capital structures and the heavy use of debt. Heavy leverage has been a traditional way of financing in Europe, but it is viewed as a negative by most U.S. investors, who prefer to see a more balanced mix of debt and equity. That is all part of the evolution of these companies. They are learning the importance of selling equity and finding out that they need to make changes to become more attractive to investors, including providing better disclosure and honest accounting."

OTHER IMPROVEMENTS

"I would love to have earnings per share taking out all options. I also really want that insider information-the whole area related to the personal side of management remuneration, including types and levels of remuneration, which most companies give freely, but some don't. This sort of information is most important."

"They could use better, more consistent standards as to presentation of their financial statements. And a better standard on the application of goodwill and acquisition accounting across the board would be helpful."

"Adopt IAS and report quarterly. The Europeans actually have more of an impetus to go to a common accounting standard than the U.S. does because they are trying to integrate their economies and become more powerful as a regional player. Agreeing to a single accounting standard would be one more step in that direction."

BETTER COMMUNICATIONS

"There is no substitute for coming to the U.S. to meet with us. I think there is also a tendency to buy the stocks you know the most about and you know more about the stocks where management is more visible. So there is no substitute for face-to-face contact."

"Occasionally, you get an arrogant management that doesn't want to tell you anything and say's 'Trust us.' The ones who forever say 'trust me' are the ones where I won't own the stock. But that's pretty rare now whereas five years ago that was the rule, not the exception. I really find that if I need something, I can get it and my communications with managements are very productive."

"Continental European companies should be more transparent and explain things better but internally, management does not see a need to do this. Companies have to believe that the equity markets are a practical and feasible way for them to lower the cost of capital over the long term."

BILL JENKS
Makinson Cowell is a capital markets advisory firm founded in 1989 that provides independent research and advice to leading global companies on their relations with institutional investors. With 60 people in offices in London, New York and San Diego, the firm has a special expertise in advising global companies on cross-border investment issues.

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