IDC Independent Directors Council
Promoting Excellence in Fund Governance

Mutual Fund Industry Urges Accounting and Auditing Reform, July 2002

Mutual Fund Industry Urges Accounting and Auditing Reform

Washington, DC, July 8, 2002 - The Investment Company Institute today expressed the mutual fund industry's strong support for action by the Senate and the enactment of accounting and auditing reform legislation by Congress.

In a letter to Senate Majority Leader Tom Daschle (D-SD) and Senate Minority Leader Trent Lott (R-MS), Institute President Matthew P. Fink said meaningful steps are needed to reinforce the accuracy and honesty of the financial reporting system that investors depend on to help attain long-term financial goals, such as retirement and education.

"In particular, we believe a consensus exists among those who review the financial condition of publicly held companies that it is necessary to bolster the independence of the accounting standard-setting process, strengthen the oversight of public auditing, and increase the authority and resources of the Securities and Exchange Commission," Fink wrote. "Toward that end, bi-partisan legislation passed the House earlier this year and the Senate is about to consider legislation reported by the Senate Banking Committee."

Fink noted that the SEC also has proposed far-reaching changes to the financial reporting regulatory systems and key market participants have moved forcefully to examine these issues.

"We believe it is important to focus on the overriding importance of reinforcing confidence in the financial reporting system for publicly held companies," Fink wrote. "Today, the need for middle-income families to save and invest is more important than ever. In the absence of a coherent legislative and regulatory response, revelations about shortcomings in the nation's financial reporting system could erode confidence in investing as a prudent means to achieve long-term savings and investing goals."

The Institute said a “strong and thoughtful” response by Congress would bolster the efforts of the SEC and key market participants, and would effectively address the “disquieting uncertainty” investors may feel about the quality of their investments and the reliability of investing. “We encourage your leadership in assuring that legislation is enacted this year,” Fink wrote.

The Institute’s letter is the latest in a series of recent initiatives the mutual fund industry has taken on behalf of its shareholders to improve corporate accounting and auditing practices. The Institute’s members invest $4 trillion in U.S. equity and fixed-income securities on behalf of 93 million individual shareholders.

For example, in a June letter, the Institute called upon the SEC to strengthen corporate reporting of insider selling. Noting its strong support of the Commission’s proposal to amend Form 8-K, the Institute said its members are very interested in having timely access to information about transactions in an issuer’s securities by corporate insiders.

“This information can provide useful insight on management’s views on the company’s performance and prospects, and provide an indication of the extent to which management’s interests are aligned with those of the company,” Fink said.

In a May letter, the Institute recommended to the SEC that companies making public earnings announcements be required to promptly file the earnings information with the SEC. In addition, whenever the announcement includes pro-forma or non-standardized earnings information, this filing should include a side-by-side reconciliation of the announced earnings to GAAP, along with a plain-English narrative description of any differences.

“Mutual fund managers are encountering far too many situations in which companies report earnings with great fanfare but limited detail. Then, after several weeks and much activity in the market, the data that reveals what the announcement did—and did not—account for is finally provided,” Fink said. “Reforming SEC rules in the way we propose would enable fund portfolio managers to make better investment decisions on behalf of fund shareholders.”

The Institute also wrote to the New York Stock Exchange earlier in May to reiterate its long-standing position that exchange rules should require shareholder approval of most stock option plans. “We did so because if these plans are not subject to appropriate checks, they can have the effect of transferring wealth or voting power from public investors to management,” Fink said.
