Investor confidence, fair disclosure and stock options



CHAKLADER MAHBOOB-UL ALAN writes from Madrid

NVESTOR confidence is vital for the proper functioning of a capital market. In order to maintain investor confidence in the system, the concept of fair disclosure is important because one of the principal objectives of this concept is to avoid all possible misstatements, misrepresentations or misleading information in the financial statements of a business concern In the Enron scandal which substantially undercut corporate integrity with the public, even though the accounting treatment of the stock options did not play as important a role as off-balance sheet vehicles, the scandal brought the subject of stock options and fair disclosure into sharp focus. Thanks to this and other similar scandals, all of a sudden, the ordinary public,

meaning small investors , have come to realise how widespread the use (and abuse) of stock options is in corporate America and how the establishment (the directors, accountants, auditors, investment analysts and regulators) has sysprovided them with tematically misleading information. They have been astounded to find that stock options form a very significant part of top management's (the people who have the power to cook the books) compensation package (58% of the compensation package of CEOs of big US corporations). Sadly, they have come to learn a lot about round trip transactions, stock price manipulations, insider trading and profiteering. Now, in this context, several questions can be asked: Why so much attention has been given to the stock options in recent months? What is their connection with misleading information, stock price

has, no doubt been fractured? Among the many factors that are used to judge the performance of the management of a company in a given period, there are two which stand out as being more important

manipulations, insider trading etc.?

What measures should be taken to

restore investor confidence, which

income) and the price of shares in the stock market during the period.

Until the early 1980s, it was standard practice in the US and elsewhere to give earnings -based incentives like performance bonuses to the management. (So the temptation for the corrupt management was to cook the books to fake the net profit.) But it was not corporate America became greedier ("infectious greed according to Greenspan). In the 1980s and the 1990s, the management persuaded the boards and the shareholders to give them equitythe earnings-.based incentives, like commissions and bonus payments and equity- based incentives like free shares are automatically expensed in the same period, the stock options are not. (It is interesting to mention here that for tax purposes, options are allowed as expenses.) If the stock options were also expensed, the reported net earnings will be reduced, which will inevitably have a negative effect on the share prices. Thus by not expensing the huge numbers of stock options, the principle of fair disclosure is violated. In effect, the ordinary investors are cheated

_ETTER FROM EUROPE

First of all, we have to address a fundamental question: What is the primary objective of company accounts? Is it to give a true and fair view of company's affairs or as the Financial Times recently complained "to deliver a steady flow of announcements to the markets in ways that will push up - or at least prop upthe share price"? In my opinion, company

based incentives. The idea, in itself, was not bad, and in the late eighties may even had a beneficial effect on new-technology companies, where the future was uncertain and the shareholders wanted their managers to have a stake in the company But later the shareholders, who had become used to the stock market bonanza, ("irrational exuberance" in Greenspan's eloquent words), not only wanted more and more dividends, but also wanted to see the value of their stock portfolios rise incessantly. Thus started the excessive use (and subsequent abuse) of stock options as incentives for the management. If a stock option, is merely a right

to purchase shares of a company at certain price (which is usually lower than the market price), and in any case, if the companies often have to lend money to the managers under dubious legal circumstances) to exercise the options, or sometimes even have to buy back shares from the stock market in order to sell them immediately afterwards to option holders, why not simply give away shares (instead of options) as incentives to the mangers? Well, because the

accounting treatment of these two

items are completely different. While

because they are persuaded to buy shares at artificially inflated prices.

The story does not end here. It opens up the possibility of further financial shenanigans by creating perverse incentives. If the company does not specifically prohibit the lending of money to its officers for the purpose of exercising stock options, it often incurs unnecessary financing costs by lending money to its officers to buy its own shares. If no time limits are set on how long the options must be held before they can be cashed, in order to maximise their personal profits, the managers may choose the time and opportunity to manipulate the company figures for artificially escalating asset values. Furthermore, since they handle all pertinent "inside information", they are in a perfect position to cheat the ordinary investors by getting rid of their (and their family's and friends') shares in the company they manage at high prices, immediately before the share prices plunge in the stock market. Actually, a survey of recent option deals suggest that chief executives smaller companies took option profits immediately before the share prices plunged in the stock market What can be done to avoid all this or

the market is unfortunately not truly efficient, what can the accountants do to protect the ordinary investors who are ignorant of the hidden facts and figures behind the reported figures? In short, how can investor confidence be restored?

First of all, we have to address a fundamental question: What is the primary objective of company accounts? Is it to give a true and fair view of company's affairs or as the Financial Times recently plained "to deliver a steady flow of announcements to the markets in ways that will push up - or at least prop up-the share price" ? In my opinion, company accounts must conform to the principle of fair disclosure. Their primary purpose is to reflect clearly - I insist clearly - the health and wealth of the company at a certain date or for a certain period. They must not carry any misstatements, misrepresentations or any misleading information. Stock options, which many cases

are worth hundreds of millions of dollars have become material factors in evaluating the real earnings of a company. Therefore, they must be treated as expenses. (The Financial Accounting Standards Board and the International Accounting Standards Board must get their act together and change their rules to this effect. At the same time they should come up with an acceptable formula for valuing the options.) It is heartening to note that such icons of American capitalism as Boeing, Winn-Dixie. Coca-Cola and Washington Post have already decided to expense the options. As a result, they have already gained credibility with their investors. Option agreements must oblige the holders to retain their stock for five years. The same restrictions should also be applied to managers, who are given free shares. These measures will substantially reduce the management's temptation to fiddle the accounts for their personal benefit . Eventually corporate America will regain the ordinary investor's trust. After all, stock markets are about trust. Without trust and confidence, investors will gradually shy away from the stock markets and opt for "liquidity preference". If it happens, it would certainly be bad for the economy as a

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Development, state and governance A Caribbean experience

ARINDAM BANIK

HE issue is not easy to resolve. We all have intuitive notions of " development". When we speak of a "developed society", we visualise in our minds a society in which people are well fed and well clothed, possess access to a variety of commodities, have the luxury of some leisure and entertainment, and live in a healthy environment. We think of a society free from violent discrimination, with acceptable levels of equality, where the sick receive proper medical care and people do not have to sleep on the sidewalks. In short, most of us would insist that a minimal requirement for a "developed" nation is that the physical quality of life be high. and be so uniformly, rather than being restricted to an incongruously affluent minority

Of course, the notion of a good society goes further. We might stress political rights and freedoms, intellectual and cultural development, stability of the family, a low crime rate, and so on. However, a high and equally accessible level of material well-being is probably a prerequisite for most other kinds of advancement, quite apart from being a worthy goal in itself.

In reality, things are different in developing countries. To quote, " If government sanctions \$1 for the poor, the poor beneficiary will get only 25 cents of the dollar sanctioned" (World Development Report 1999). In other words, the system will eat the remaining amounts in the form of transaction costs. This observation is common across most of the developing nations. This problem reminds us the weak role of institutional infrastructure required for a market economy.

Here lies the concept, "government failure leads to market failure". Government should have a role in this context. The state and the market are complements, and it is important that the state undertakes its " responsibilities" and does so effectively and efficiently. The articulation of the theory of market failure, especially as applied to developing countries allows us to understand the appropriate role of

Policymakers often debate about the appropriate role of the state in implementing development programmers. The government failure leads the funding agencies to explore the alternates, the nongovernment organisations (NGOs).

Yet, one can reject most of the conclusions of " trickle down economics" in developing countries with a few positive micro results in Asia and Latin America

Good governance institutional accountability, the integrity of the politicians sometimes can make the thing different. The experience in few Caribbean countries with particular reference to Barbados shows the NGOs are not alternates to the government. If government is really concerned with improving the living standards of its people, it can do so. Indeed, the experience suggests a bit. Think of what we consume as our income increases. Our first needs are for food and clothing. As we have more income to spare we switch to industrial products: radio television bicycles automobiles and the like. At a still higher level of income we begin to register a high demand for services: banking. tourism, restaurants, and travel. It is not surprising, then, that the developed countries allocate a large fraction of their non-agricultural labour force to the services sector. Countries such as Australia, the United States, Norway, and Sweden

In recent time foreign companies in USA are targeting developing countries for setting up international call centers (offshore call center). These companies hope to leverage the few developing countries' clear advantage: a huge pool of English-speaking, computer literate and relatively low-cost college finance and computer graduates. The local companies eager to improve customer service and gain a competitive edge over rivals are also setting up domestic call centers. This has been a major source of foreign investment. Indeed, it has created a significant number of jobs in

that rather than there being a conflict between governance and institutional accountability, the two should be complements. The island nation's effective education policies, for instance, played a pivotal role in economic development. This has led to political and social stability, thereby creating a better investment environment.

It is imperative to mention that a decade ago donors tried to reduce poverty by delivering project with a high social rate of return. This approach encountered mixed results across developing countries. The social cost benefit analyses of the projects in the region reveals an interesting trend. Most of the aid and grant dominated projects failed in various parts of the world. In contrast, the implications of using aid in transforming society and human capital are commendable in the

How education policies and economic development are related? It is useful to conceptualise matters

have about 70 per cent labour force in the services sector. In Barbados. the data shows about 79 per cent of the total labour force was engaged in the service sector in the year 2000

Rich countries not only have access to a large stock of physical capital, but by investing time and money in education, it is also possible for these countries to produce a large stock of human capital: labour that is skilled in production, labour that can operate sophisticated machinery, labour that can create new ideas and new methods in economic activity. It is important to contrast this form of labour with unskilled labour. Developing countries are likely to have a shortage of the former and a surplus of the latter.

The Caribbean experience reveals an interesting aspect in this context. The policymakers at the initial stage of development targeted the formation of social capital in the region. That implicitly explains less demographic pressure. It was

thus easier to educate the population with the help of state intervention. In the process social capital and trust made economic transactions more efficient by giving parties access to more information. enabling them to coordinate activities for mutual benefit, and reduced opportunistic behaviour through repeated transactions. Indeed, this played a significant role in shaping the outcomes of economic action at both macro and micro

History portrays the single most determinant factor in explaining the Caribbean success. The efficient and effective public intervention in education, health and related services contributed immense benefit to the quality of life of the country. These lessons have considerable bearing on future policy for developing countries since public support measures have been under severe scrutiny in Asia. Africa and Latin America In fact the trend of grants and aids sanctioned by developing countries to the developing world has had been declining due to corruption.

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omy with surplus labour can only sustain its economic development based on multiple skill and diversifying services. The economic actions are guided by political action. But their success depends greatly on their political background. Economic development ultimately derives from a homegrown strategy, not from world market.

AIDS flares up in Africa and parts of Asia

Can Bangladesh remain complacent?

MD ASADULLAH KHAN

N most African and Asian countries AIDS epidemic has hit with devastating force. From America to Africa to Asia to Europe, the story of AIDS is one of scientists racing to develop better treatments and succeeding. During the past couple of years, potent new drugs have eased AIDS mortality throughout the developed world, and preventive efforts have slowed the spread of HIV. But in sub-Saharan Africa, the AIDS crisis is looming up dangerously and it's a story of hopelessness. Twenty-four million of the area's people are HIV-positive -- 70 per cent of the world's infected population. Seventeen million Africans have already died of AIDS with 3.7 million of them children, and 10 million more are suspected to die within five years. In South Africa one in five adults is infected, in Botswana the rate of infection is one in three, in Zimbabwe it is one in four. According to U.S. Census Bureau, by 2003, AIDS related deaths will slow population growth in some of these

nations to zero and the population in Botswana, Zimbabwe and South Africa will actually start to decline. Life expectancy by the end of this decade would normally have been about 70 in this part of Africa, but as a result of AIDS it will plummet to 30. Census Bureau's chief investigator Karen Stanecki said in the 13th AIDS conference held in Durban, South Africa in 2000. "It is hard to comprehend the mortality it will see in those countries". Most poignantly Botswana will probably have 2,14,000 orphans

Speaking in general, worldwide, according to a new report from the United Nations' AIDS office (UNAIDS), a staggering 30 million people are now living with HIV. Nearly six million contract the virus every year -- some 16,000 every day. Take the case of South Africa, a relatively prosperous country with a vast wealth of Gold and diamonds deposit till now, but because of AIDS its economy is now a total wreck. South African President Mbeki's HIV skepticism has rendered the situation much more critical. South Africa

at the present moment has the largest number of people living with HIV/AIDS, about 20 per cent of its adult population, up from 13 per cent 1997; 4,20,000 children have been orphaned and 2,50,000 people die each year from the disease. Far from a renaissance, sub-Saharan Africa is in the throes of a plague of medieval proportions. Even at 80 per cent discounts, treatment therapies are simply beyond the means of the continent's governments. Yet amid the despair at least two countries have managed to address these problems. Led by President Yoweri Musoveni, Uganda started a public AIDS education programme that has driven the rate down from 30 per cent in 1992 to about 11 per cent in 2000. And in Senegal, with its own

> adults, one of the lowest in Africa. But terrible as these numbers are, they're bound to get worse. While efforts in developed countries focus on modest advances in AIDS treatment, the central dilemma is how to fight this voracious plague under the conditions that made the continent so vulnerable in the first place. One reason AIDS has hit sub-Saharan Africa so hard is that the public health system in many countries is inadequate to deal with even "conventional" diseases, let alone a arinding juggernaut like AIDS. According to World Bank, the region averages \$34.00 per person annually in health care spending -- and far less in places like Nigeria and Kenya -- compared with an average of \$ 2,485 in developed countries like the U.S. Less than half the people in the area have access to clean water, and just over half of all children are vaccinated against diphtheria, polio and tetanus. The notion that African countries can somehow buy and distribute some of the expensive drugs that can prolong lives for those infected with HIV -- even at the drastically subsidised rates that some companies have promised -- is

awareness programme and religious

leaders joining the AIDS education,

the infection rate is a mere one in 50

already weak economies have. Starting from Africa to Asia say India. Bangladesh or China or the Philippines or Myanmar the problem

far fetched. Beyond that, the illness

and death of so many workers is

draining what little strength these

spread of HIV within its borders. One major problem is a common porous border with India and Myanmar, both of which are currently experiencing HIV affliction. How can Bangladesh remain is that while AIDS is almost completely preventable, prevention methods must be taught to potential victims. Yet sex education is almost

rare in all these places. People lack

even the most basic understanding

of how the disease is spread.

According to an estimate by WHO and UNAIDS, the number of HIV infection cases in Bangladesh

is not negligible. These include migrant workers, sex workers, truck drivers and some

housewives. Ominously, the country exhibits several risk factors, which could facilitate the

Even with a negligible infection rate till now in Bangladesh -- only 126 reported cases so far -- the nation has hardly any reason to feel complacent. Curiously enough, most of the HIV infected males (104) detected so far out of 126 are emigrant workers who returned home following diagnosis. The obvious reason for surveillance is that almost a staggering number of such workers would be thrown back to Bangladesh because of precarious employ ment opportunities in most of the countries abroad. In rich countries, the availability of anti-retroviral drugs means that most people infected by HIV (human immuno deficiency virus) can lead normal life for years if not decades. But poor countries like Bangladesh where health budget per person per year is \$12.00 cannot afford these drugs. In such countries, unless preventive measures are taken well in advance, almost all of those who are infected simply develop AIDS, and die. That means an unimaginable human tragedy is waiting to unfold for countries like Bangladesh. It is a tragedy moreover that blights almost every activity of government, every facet of the economy, every aspect of everyone's life. If unchecked or unless preventive measures are taken well in advance, it may wipe out the progress of decades of develop-

If we take the figures from our nearest neighbour India, there are obvious reasons to be worried. Based on prevalence rates and sample surveys, the joint United Nations Programme on HIV/AIDS estimated in 2001, that India has already 3.9 million people afflicted with the disease, probably the largest number in the world countrywise. Perhaps the most worrying aspect is the growing evidence in India of what HIV experts call "transmission chains", by which the virus percolates insidiously through social substrata and afflicts low risk individuals like

housewives and children. Reports

aleaned from India suggest that two sons of a Chennai-based industrial ist who are being treated for AIDS admitted that they had unprotected sex with "high class" call girls before and after marriage. Neither believed there was any risk involved so long they kept away from the official redlight areas. Now their wives are also infected. Sadly true, heterosexual transmission now accounts for over

two thirds of all HIV-cases in India. In this region, be it India or Bangladesh promiscuity is the single most important way by which the epidemic spreads. One reason for its rapid dissemination is because the symptoms of AIDS take an average of five years to show up. So an infected person can pass the virus unknowingly to scores of people. The grim fact is that the old concepts of middle class morality are breaking down. Changes in workplace is cited as a major reason. Industrial growth and expansion in business activities have spawned a breed of travelling executives who spend nearly half their working lives away from home. At the same time around the globe with no exception to Bangladesh and India, women have become an increasingly visible part of the professional workforce. Put these factors together and you have the settings for an increasing number of casual sexual relationships.

The irony is that while in the West having multiple sexual partners is now considered "high risk behaviour", in our region at least for some it has just become fashionable, a symbol of liberation and upward mobility. At the same time, some women are shedding their inhibitions and sexual expectations are running high. Nevertheless, with premarital sex gaining increasing acceptance among the new generation the incidence of sexually transmitted diseases including AIDS has risen. In India, teenagers and those in the early 20s now constitute a third of the cases

testing HIV positive. Some studies in India, found that prostitutes topped the list of premarital sexual partners among men. These are evidently danger signals because prostitutes are a major reservoir for the AIDS virus. And with brothels dismantled in big cities in the country, the border between this original reservoir and the general population is quickly getting porous. The relatively high HIV prevalence among drug users suggests that Bangladesh is at the threshold of the epidemic which has the potential of spreading rapidly

According to an estimate by WHO and UNAIDS, the number of HIV infection cases in Bangladesh is 21,000. These include migrant workers, sex workers, truck drivers and some housewives. Ominously, the country exhibits several risk factors, which could facilitate the rapid spread of HIV within its borders. One major problem, as indicated earlier is a common porous border with India and Myanmar, both of which are currently experiencing HIV affliction. In Myanmar more than half a million of its 45m people have AIDS. Health workers fear an epidemic as bad as Africa. How can Bangladesh remain complacent in such a situation?

The risk factors include premarital sex among approximately 50 percent of about oneÊlakh migrant workers who leave their home for long periods each year, approximately threeÊlakh truck drivers and their assistants, 50 percent of whom are believed to have sex with nonregular partners on their long journeys countrywide and threeElakh units of blood used in the hospital per year of which 80 percent are reportedly drawn from professional blood donors and IDUs (Intravenous Drug Users) who share needles and over oneÊlakh CSW (casual sex worker) many of whom have a history of STD (sexually transmitted disease)

Sadly true, an omnipotent vaccine to immunise humans from the fatal effects of AIDS is yet to be identified. Hopefully, for India which already has 3.9 million people afflicted with the disease, there is a glimmer of hope: the first steps have been taken to develop an effective AIDS vaccine suitable for the country and the first phase of trials of an AIDS vaccine could begin within 18 months. Experience of the researchers suggest that the development of any effective vaccine against the vicious and fast mutating HIV, which causes AIDS is a painstakingly slow process. The virus is still wrapped in riddle. Unlike vaccines against other diseases like small pox. polio and meningitis, a vaccine for AIDS requires to be developed to suit region-specific subtypes of HIV. More than 90 percent of HIV positive cases found in this sub-continent are of the C subtype which is a mutation of the HIV virus in reaction to a genetic strain found largely in people of the Indian subcontinent.

In view of the difficulties and problems in having technological facilities in India, Indian Council of Medical Research (ICMR) and National AIDS Control Organisation (NACO) have started work with the New York based International AIDS Vaccine Initiative (IAVI), Until now preventive efforts were carried on a smaller scale. Though many vaccines are being tested for safety and effectiveness in the U.S. and parts of Africa, in Asia it is only in Thailand that an AIDS vaccine -- AIDSVAX developed by VaxGen Inc -- has reached advance stages of trial. Unquestionably true, an effective vaccine is needed because AIDS affects not just sex workers, truck drivers or those who are labelled as "high risk" groups. It is for everyone, especially those who do not perceive the AIDS risk themselves.

The saying goes, "Time is supposed to be the great healer but it's not so for AIDS. For AIDS time is simply the great killer, as far as most people are concerned." The internationally reputed journal "Economist" in its 6th October, 2001 issue pointed out that "Vietnam and China are showing abrupt rise in rates of infection in prostitutes. Bangladesh and the Philippines are recording much the same patterns of risky behaviour as the worst affected countries.' Replication of Thailand's model could yet avert a ghastly AIDS epidemic in

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All health information to keep you up to date

Children first

Certain health problems are more common at early childhood. Inadequate drinking water and sanitation, indoor air pollution, and accidents, injuries and poisonings, are a few of the causes of the three million deaths per year of children. These children are under the age of five and deaths are all related to environmental hazards.

About one and half million children under five in developing countries died from diarrhoeal diseases caused by insecure water supply, sanitation and hygiene in the year 2000. This could be the greatest danger for their generation. There should be some specific efforts both from government and NGOs in a country like Bangladesh to address the present environmental hazards, which specifically affect infants and children. We need a 'Children Environmental Health Programme'

in Bangladesh as early as possible. Children are not "young adults", they are in a dynamic process of growth and development, and they are particularly vulnerable to the acute and chronic effects of pollutants in their surroundings. Investigation suggests that over 40 per cent of the global burden of disease due to environmental risk factors may fall on children under five. To enjoy a better future it is important that we pay a very special attention to this children group.

Did you know! According to western researchers, today's print media is usually safe on health grounds, as those are germ free. The reason is -- fresh ink inhibits the growth of microorganisms. But yesterday's paper is not that safe. Those may be covered with potentially dangerous bacteria.

Next: Around the world