WELCOME TO THE WORLD CLASS

THE UNIVERSITY OF MELBOURNE

MELBOURNE BUSINESS SCHOOL

MBS.UNIMELB.EDU.AU

STUDYING BUSINESS AND ECONOMICS AT MELBOURNE

Why Melbourne Business School?

PROFESSOR NASSER SPEAR

Deputy Dean

Melbourne Business School

Agenda

- Introductions
- Overview of Melbourne Business School Programs
- Scholarships
- Entry requirements
- Finance sample lecture: “The Financial Crisis of 2008”
  - presented by Associate Professor John Handley
- Accounting sample lecture: “What To Do After that Sinking Feeling…An Accounting Story”:
  - presented by Professor Naomi Soderstrom
- Q&A

Why Study at Melbourne Business School

Our Mission

We enable individuals and organisations to be global leaders through the creation, application and dissemination of business and economics knowledge

Why Study at Melbourne Business School

Reputation

Times Higher Education Rankings 2018

- #32 in the world
- #1 in Australia

QS World University 2018 Rankings

- #7 in the world for employability

QS World University 2018 Rankings

- #14 globally for Accounting and Finance
- #22 globally for Business and Management Studies
- #25 globally for Economics and Econometrics

Wide and diverse range of program offerings

Programs for:

- Recent graduates and early career
- Experienced professionals

On campus, blended learning and fully online covering all business and economic disciplines

Recent Graduates and Early Career

Early Career Coursework

Master of Management Suite:

Accounting, Finance

Human Resources

Management

Marketing

Depending on background

1.5 - 2 years Full Time

Master of Management (Accounting and Finance)

Business background required

2 years Full Time

Master of International Business

Depending on background

1.5 - 2 years Full Time

Wide and diverse range of program offerings

Specialist Coursework

Master of Finance

Discipline background required

2 years Full Time

Master of Actuarial Science

Quantitative background required

2 years Full Time

Master of Economics

Economics or Quantitative background required

2 years Full Time

Master of Applied Econometrics

Analytical or Mathematical background required

2 years Full Time

Wide and diverse range of program offerings

Specialist Coursework

Master of Commerce Suite:

Actuarial Science

Management

Marketing

Discipline background required

1.5 years Full Time

Master of Business Analytics

1 year Full Time

Master of Marketing Communications

Depending on background

1.5 - 2 years Full Time

Wide and diverse range of program offerings

Post Experience Coursework

MBA:

Full time, Part time

Executive and Senior Executive Options

Professional experience required

1 - 1.5 years Full Time

Master of Supply Chain Management

Professional experience required

1.5 years Full Time

Master of Enterprise

Professional experience required

1.5 years Full Time

Wide and diverse range of program offerings

Doctoral and Research Programs

Program	Structure
Accounting	2 years coursework 3 years research
Finance	
Decision, Risk & Financial Sci.	
Economics	2 years coursework, 2 years research
Management	1 year coursework 3 years research
Marketing	
Actuarial Studies	3 Year research thesis only (no coursework)
Master of Commerce	

Why Study at Melbourne Business School

Accreditation

AACSB ACCREDITED
AACSB Accreditation

EFMD EQUIS ACCREDITED
EQUIS Accreditation

CFA INSTITUTE

Chartered Accountants
NUMBER ONE IN NUMBERS

CPA AUSTRALIA

NIA NATIONAL INSTITUTE OF ACCOUNTANTS

CIPS Accredited

Actuaries Institute

Why Study at the Melbourne Business School

Calibre of teaching and students

Facilities and services

Enrichment and experiential learning programs

WELCOME TO THE WORLD CLASS

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STUDENT EMPLOYABILITY & ENRICHMENT

Employability and Enrichment Opportunities

Mentoring Programs and Internships

Work Integrated Learning Subjects

Skills Workshops, Competitions, Clubs and Societies

Employability and Enrichment Opportunities

Mentoring Programs and Internships: Engage with employers and industry

Career Mentoring Program: Receive advice and guidance from experienced industry professionals over two semesters

Internship Opportunities: Apply for local and international internship opportunities offered by our growing number of industry partners

Employability and Enrichment Opportunities

Work Integrated Learning intensive subjects:
Put theory into practice

Melbourne Business Practicum:
Team based intensive consulting project in a Melbourne based company

Global Business Practicum:
Travel to an international destination to work on a real-life consulting project

Employability and Enrichment Opportunities

Skills Workshops, Competitions, Clubs & Societies: Build your networks and develop key skills

Case and Pitch Competitions: Solve a business case delivered by industry partners or pitch your way to developing your own social or digital start-up!

Personal Effectiveness Program: Attend free workshops and seminars curated to develop your employability skills

Clubs and Societies: Join one of 13 Faculty affiliated clubs and societies to expand your professional and social networks

MELBOURNE BUSINESS SCHOOL

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Entry Requirements

- Undergraduate degree - Minimum GPA
- IELTS Minimum score 6.5
- GMAT* Minimum score 630
- GRE* Minimum score 315

*Only applicable for International applicants of Master of Commerce suite, Master of Finance, Master of Actuarial Science, Master of Applied Econometrics and Master of Economics who have not previously studied an undergraduate degree in Australia or New Zealand.

Scholarships

MBS offers one of the most comprehensive and generous scholarship programs in Australia.

Scholarships are awarded on the basis of academic merit
* You will automatically be considered

Scholarships for commencing graduate students range from fee remissions of 25% to up to 100%.

Commonwealth Supported Places are awarded on the basis of academic merit.
*Not available for the Master of International Business or the Master of Finance.

Application Checklist

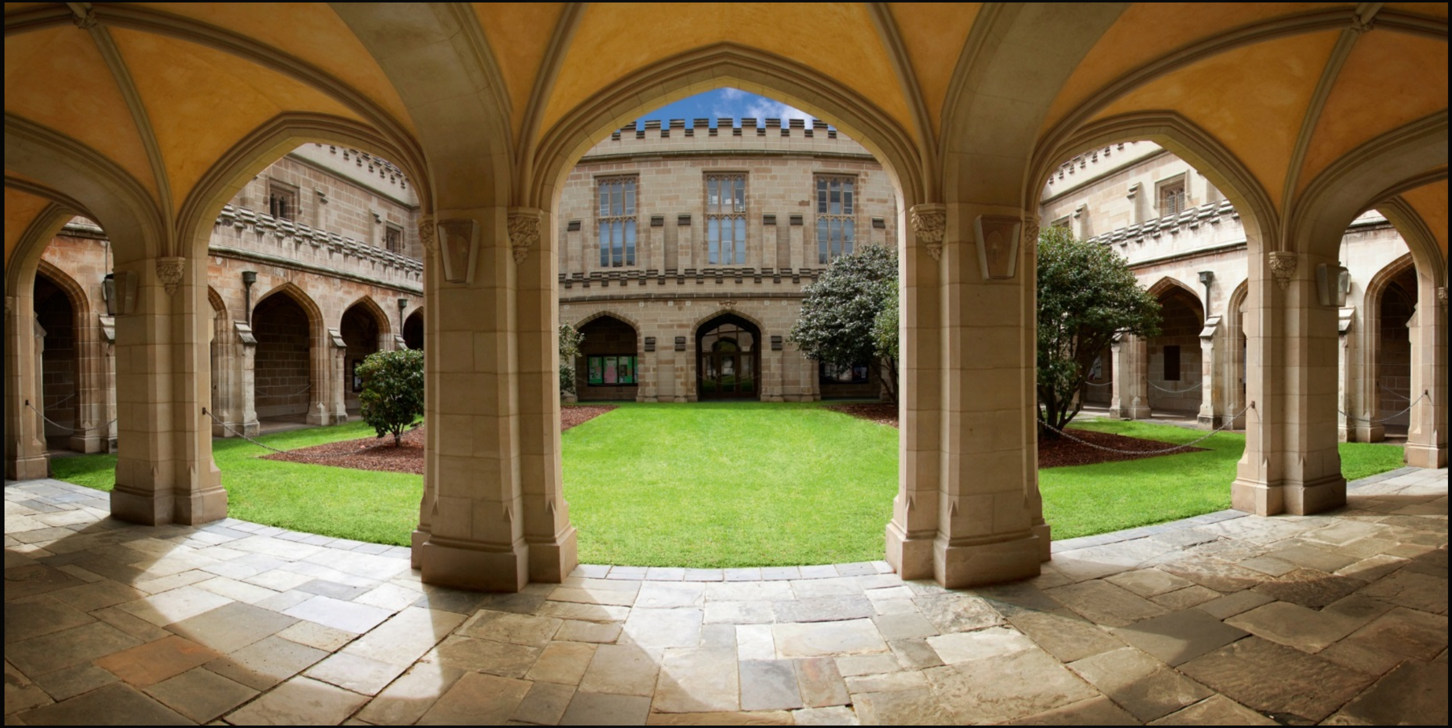
- **Transcripts**
- **Personal statement**
- **English test, if relevant**
- **GMAT/GRE test, if relevant**

- **Application closing dates**

  Semester 1, 2018
  - International applicants - 31 October 2017
  - Domestic applicants - 30 November 2017

  Semester 2, 2018
  - International applicants - 30 April 2018
  - Domestic applicants - 31 May 2018

Thank you



THE FINANCIAL CRISIS
OF
2008

Associate Professor John Handley
Department of Finance

10 October 2017

WHAT WE WILL TALK ABOUT TODAY …

- What was it ?

- How did it happen ?

- Who was to blame ?

- Is it over ?

- What is the most important lesson to be learned ?

  … *at least the way I see it anyway ☺*

1. THE FINANCIAL CRISIS OF 2008

Imagine it is January 2008. There are currently five “big” U.S. Investment Banks:

Goldman Sachs

BEAR STEARNS

Morgan Stanley

Merrill Lynch

LEHMAN BROTHERS

What are the odds that shortly there will be only two ?

1. THE FINANCIAL CRISIS OF 2008

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Morgan Stanley

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The Crisis in a Nutshell …

"**In the fall of 2008**, the credit squeeze, which had emerged a little more than a year before, ballooned into Wall Street's **biggest crisis since the Great Depression**. As hundreds of billions in **mortgage-related investments** went bad, mighty investment banks that once ruled high finance have crumbled or reinvented themselves as humdrum commercial banks. The nation's largest insurance company and largest savings and loan both were seized by the government. The channels of credit, the arteries of the global financial system, have been constricted, cutting off crucial funds to consumers and businesses small and large"

– New York Times, 2009

Here is the timeline …

2001 **2007** **2008** **2009** **2017+**

U.S. Govt encourages home ownership

Fed drops interest rates to fend off recession

Housing bubble bursts

Jun 07 Two Bear Stearns Hedge Funds collapse

Mar 08 Fed brokers sale of Bear Stearns to JP Morgan

7 Sep 08 Treasury seizes Fannie Mae & Freddie Mac

14 Sep 08 Merrill Lynch sold to BoA

15 Sep 08 Lehman files for bankruptcy protection

17 Sep 08 AIG bailed out

Oct 08 $700B Stimulus

Feb 09 $780B Stimulus

2011 Greece bond crisis

Greece ?
China ?

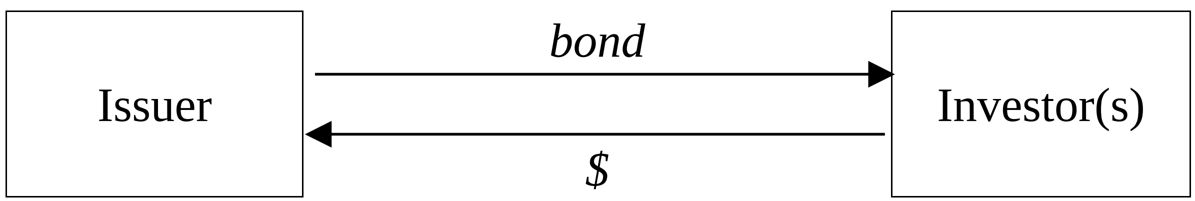
2. BACKGROUND CONCEPTS

Many factors contributed to the Financial Crisis but first here a few key concepts to set the stage …

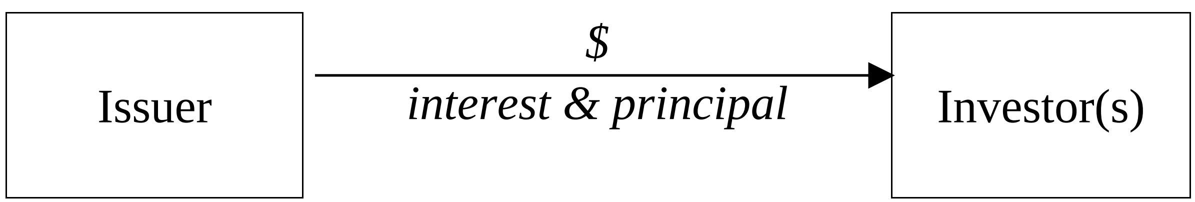
2.1 Bonds

A bond is a financial security pursuant to which the issuer (or borrower) **promises to make pre-specified cash payments** to the investor (or lender) on pre-specified dates in the future in exchange for receiving cash upfront

At the start …



Over time …



Even though bonds come in many different shapes and sizes and are called many different things …

- fixed income security
- **debt security**
- fixed rate bonds
- floating rate bonds
- corporate bonds
- Treasuries
- bearer bonds
- senior bonds
- junior bonds
- junk bonds
- MTN
- **MBS**
- ABS
- **CDO**
- **CDO^2**
- bills
- commercial paper
- Munis
- debentures
- green bonds
- indexed bonds
- euro bonds
- foreign bonds
- Yankees
- Bulldogs
- Samurais
- Kangaroos
- loans
- **mortgages**

… the common feature is that the **issuer promises** to make pre-specified cash payments to the investor on pre-specified dates in the future

… in other words:

“debt is debt is debt”

2.2 Credit Risk

The **risk** that an issuer (borrower) **defaults** on the promised cash flows on the bond

Assessed by specialist financial intermediaries (rating agencies) who assign **credit ratings** to bonds

General summary of the opinions reflected by our ratings

Investment Grade	**AAA**	Extremely strong capacity to meet financial commitments. Highest rating
	AA	Very strong capacity to meet financial commitments
	A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
	BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
	BBB-	Considered lowest investment-grade by market participants
Speculative Grade	**BB+**	Considered highest speculative-grade by market participants
	BB	Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions
	B	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments
	CCC	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments
	CC	Highly vulnerable; default has not yet occurred, but is expected to be a virtual certainty
	C	Currently highly vulnerable to non-payment, and ultimate recovery is expected to be lower than that of higher rated obligations
	D	Payment default on a financial commitment or breach of an imputed promise; also used when a bankruptcy petition has been filed or similar action taken

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Pop Quiz 1 …

How Many U.S. Corporations Are Currently Rated AAA ?

Pop Quiz 1 …

How Many U.S. Corporations Are Currently Rated AAA ?

"Back in 1980, more than 60 companies had the vaunted AAA rating. With Exxon Mobil's downgrade by Standard & Poor's Tuesday … [there are now] **only two**: Johnson & Johnson and Microsoft Corp."

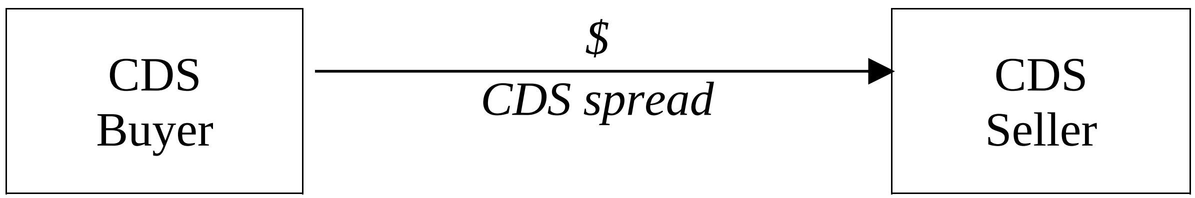
– Wall Street Journal, 26 April 2016

2.3 Credit Default Swaps (CDS)

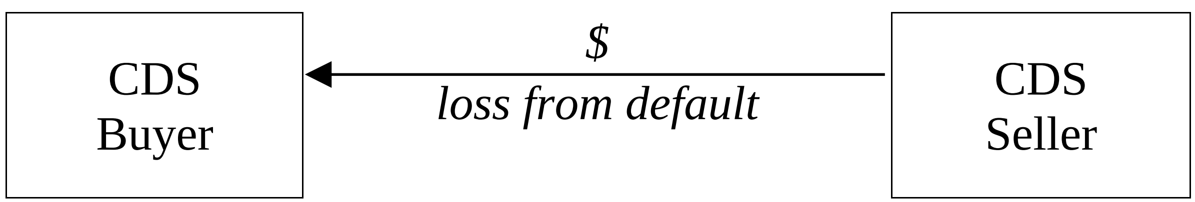
A CDS is a derivative security whose value is determined by the value of an underlying bond (or portfolio of bonds)

You can also think of a CDS as a being like an **insurance contract** …

At the start of each quarter …



But **if the issuer** of the underlying bond **defaults** during the life of the CDS **…**



CDS allow (i) bond investors to **hedge the credit risk** of a bond and (ii) others to **speculate on the credit risk** of the bond (without actually trading the bond)

2.4 Securitization

The promised cash flows generated by a pool of **one set of bonds** (or from some other dedicated source) is **exclusively** used to **service** the promised cash flows on **a second set of bonds**

Even though the concept was not new, there was an explosive growth in the **(mis)use of securitization** in the lead-up to the Financial Crisis

Pop Quiz 2 …

Which Well-Known Rock-Star Raised $55 million in 1997
By Securitizing His Future Music Royalty Payments ?

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Pop Quiz 2 …

Which Well-Known Rock-Star Raised $55 million in 1997
By Securitizing His Future Music Royalty Payments ?

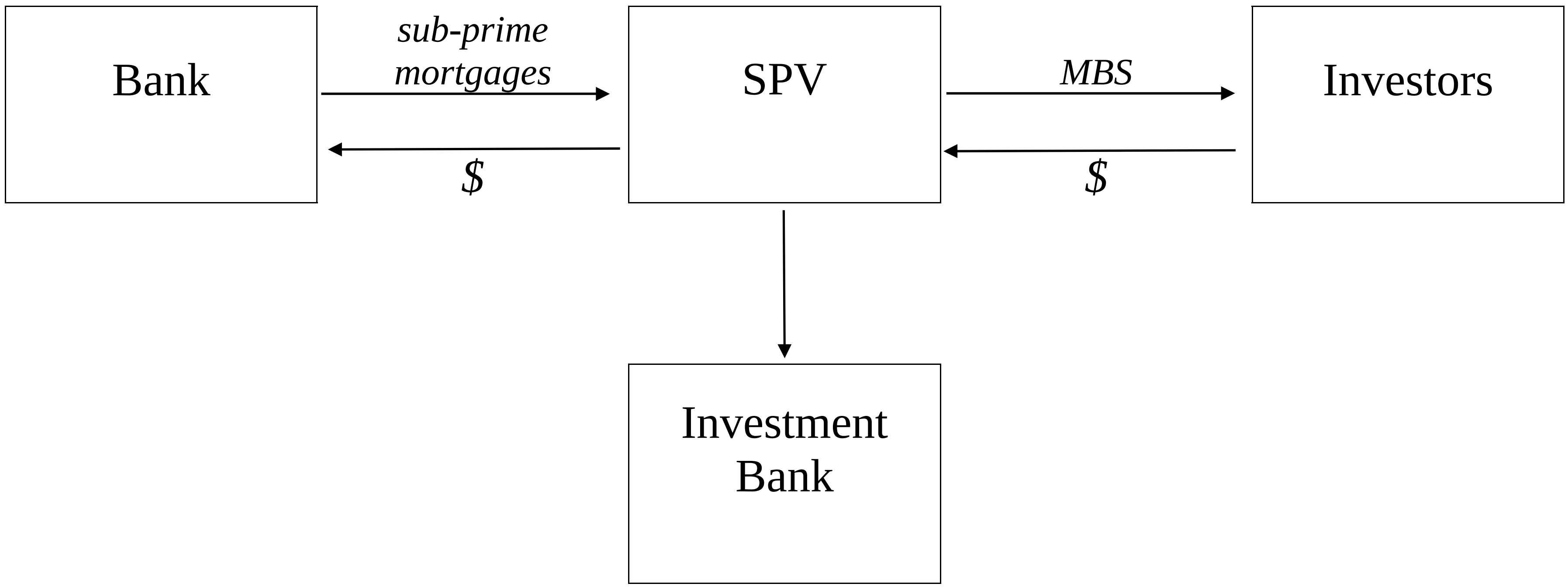
"Moody's Investors Service has assigned an A3 rating to the [JTEC] music royalty securitization. This rating is based on the historical performance of the assets, which are record master and publishing rights on compositions written and recorded by the musical artist **David Bowie**"

– Moody's, 13 February 1997

3. WHAT WAS SECURITZED ?

The banks who originated the **sub-prime mortgages** did not want them on their balance sheet. So these were the first asset to be pooled and securitized and used to service new securities called mortgage-backed-securities **(MBS)** …

On Set-up …



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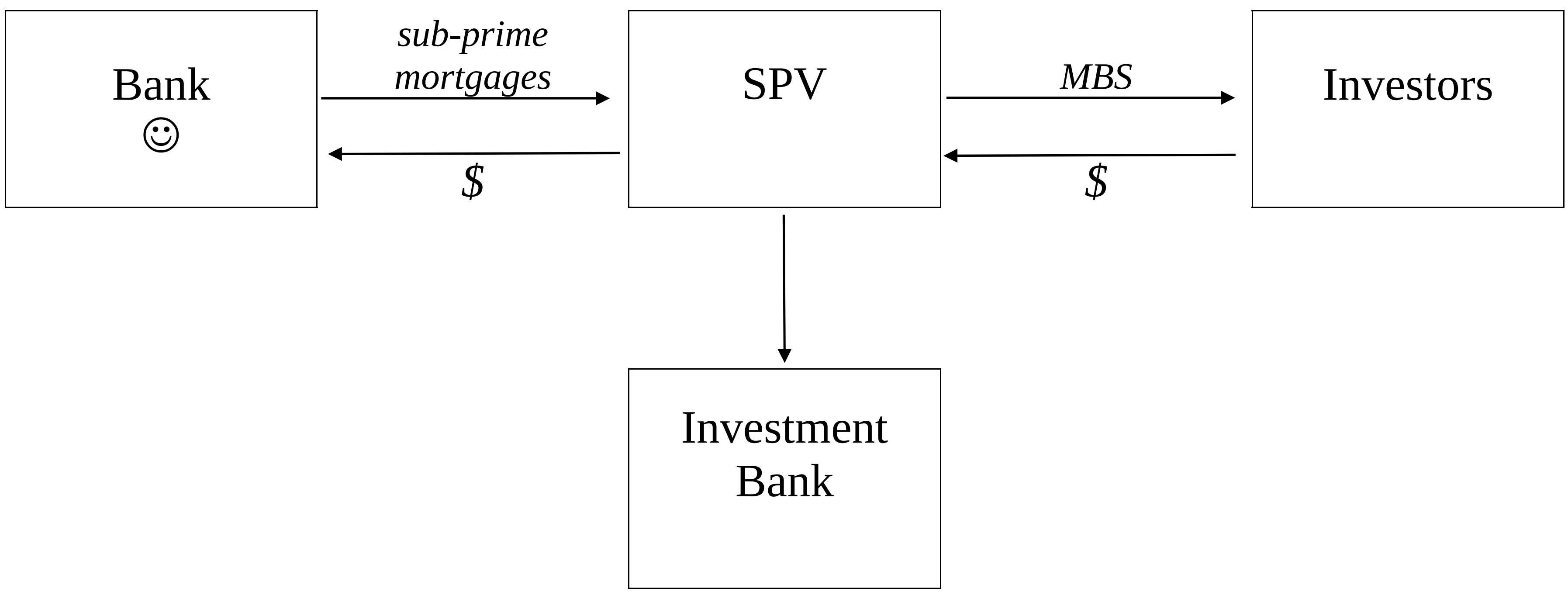

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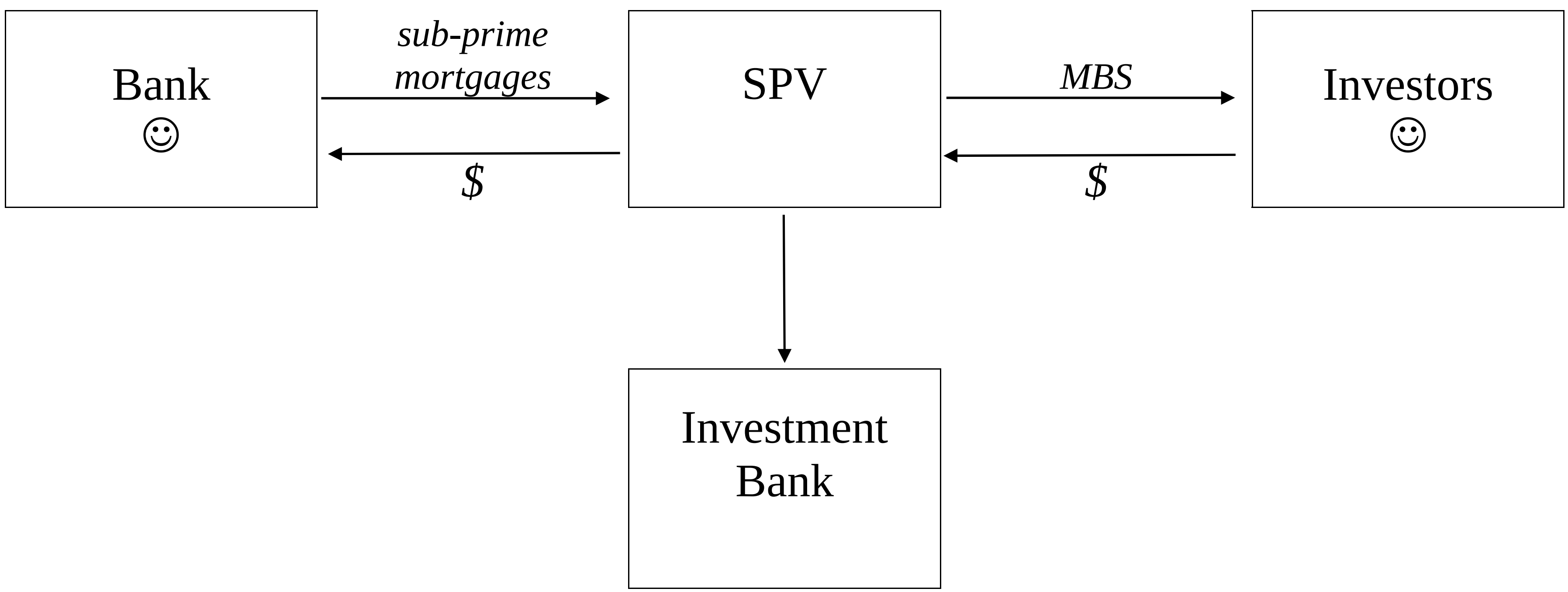

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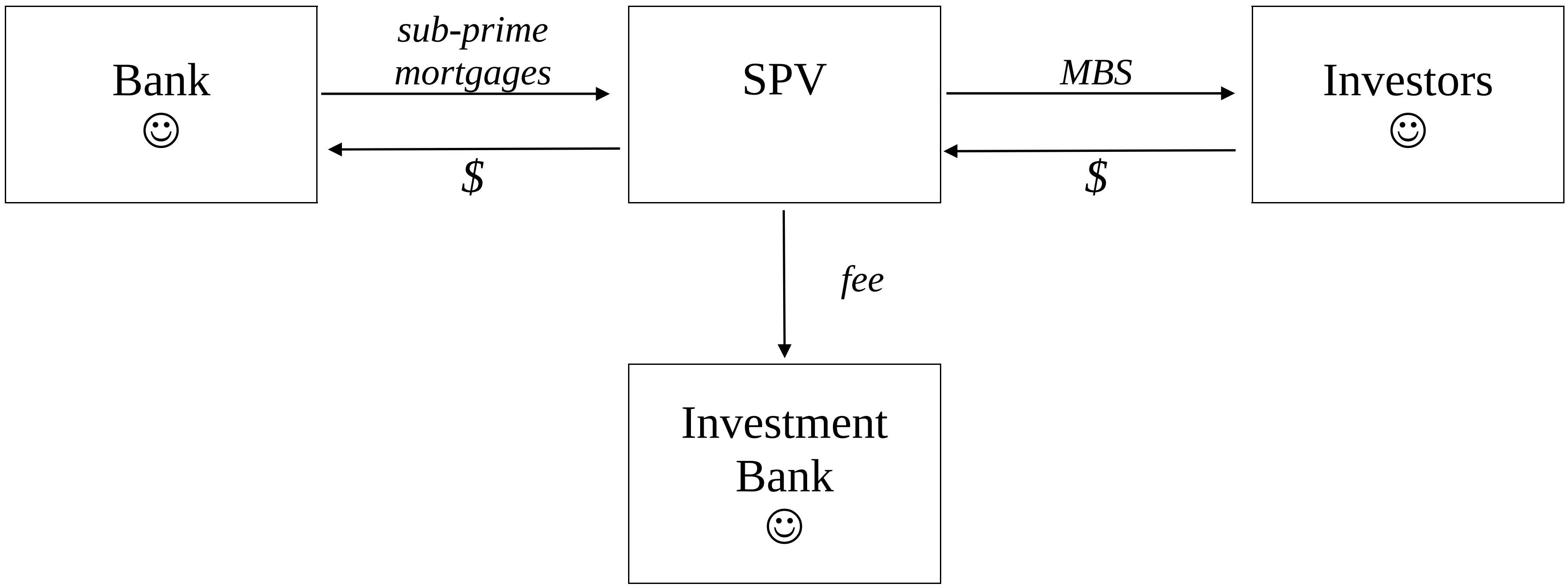
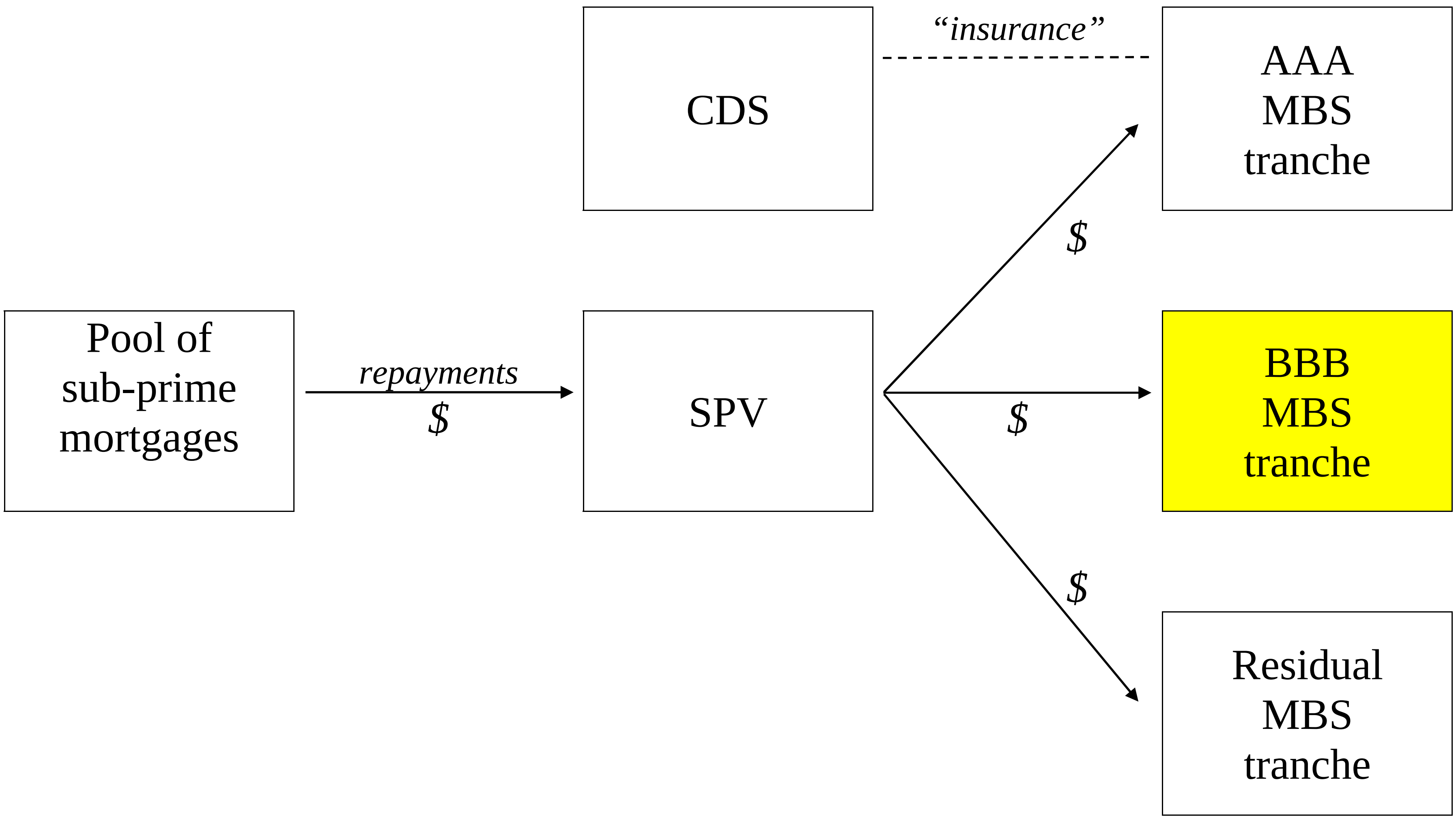
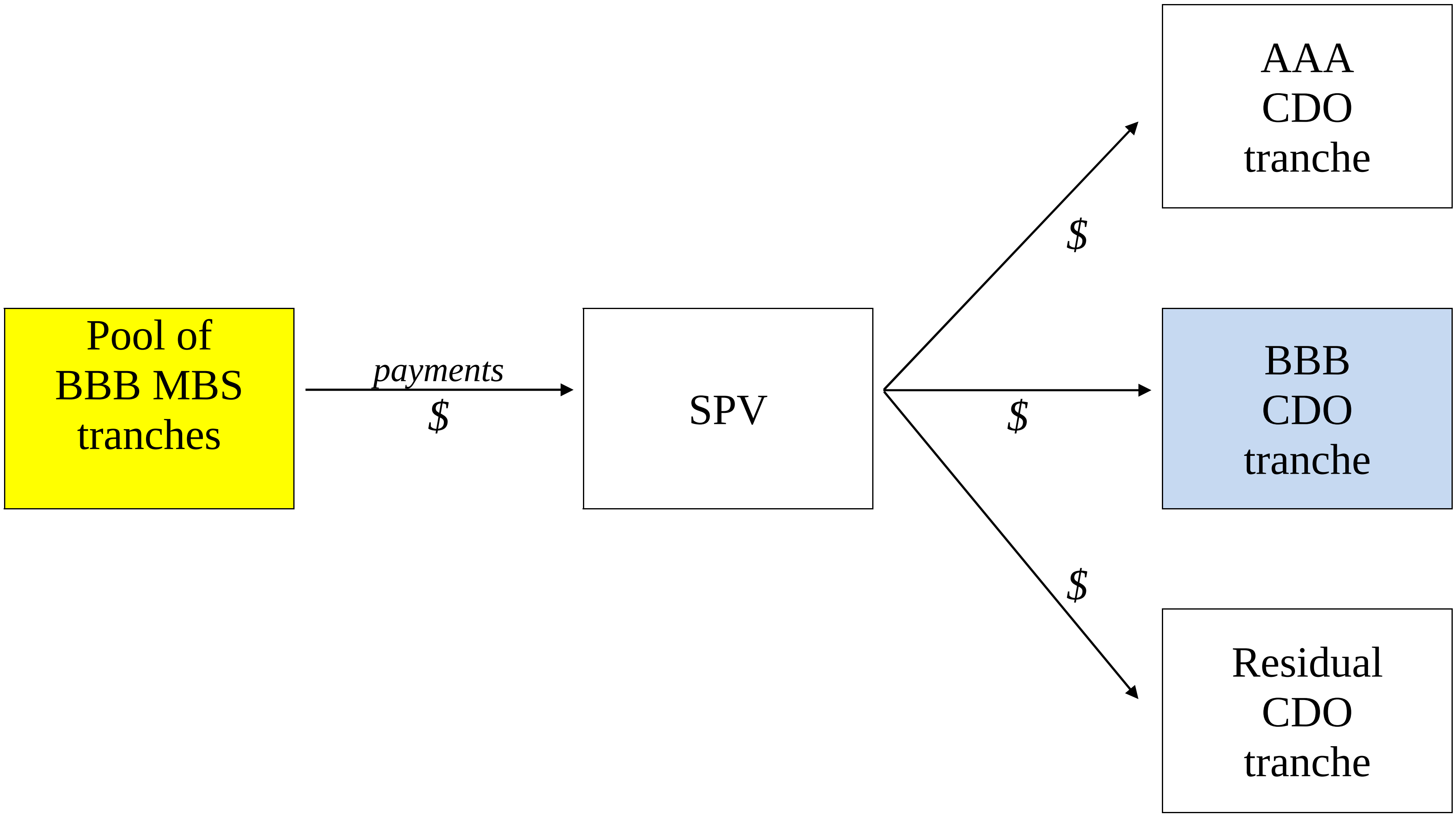


Over Time …

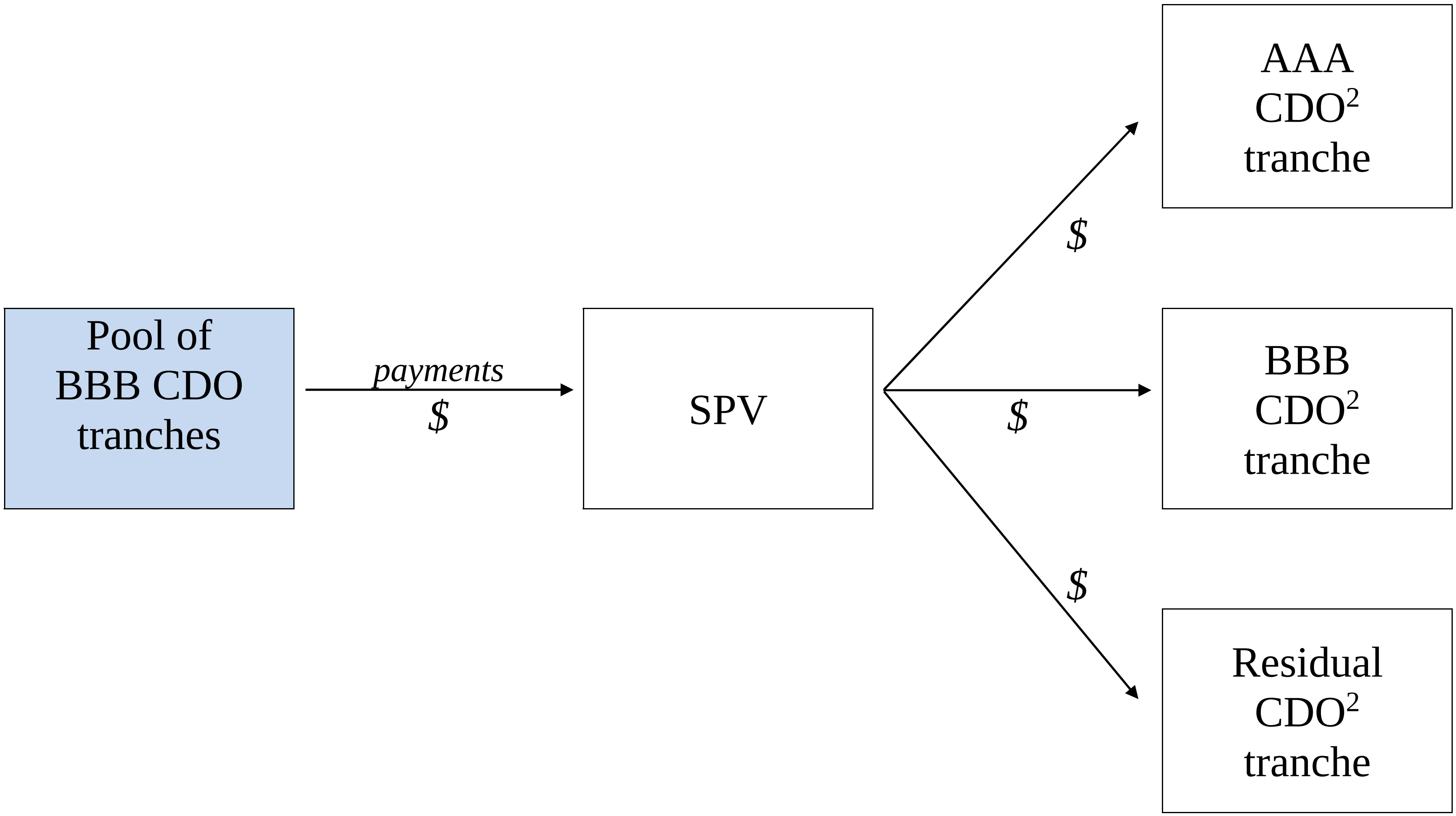


CDS
“insurance”
AAA
MBS
tranche
$
Pool of
sub-prime
mortgages
repayments
$
SPV
$
BBB
MBS
tranche
$
Residual
MBS
tranche

The AAA MBS tranches were **marketed as low-risk-high-return** securities and so were easy to sell to investors… but not so the BBB MBS tranches. So these were the second asset to be pooled and securitized and used to service new securities called collateralized debt obligations **(CDO)** …



The AAA CDO tranches were **marketed as low-risk-high-return** securities and so were easy to sell to investors… but not so the BBB CDO tranches. So these were the third asset to be pooled and securitized and used to service another level of new collateralized debt obligations called CDO-squared **(CDO^2)** …



And there was still more …

The CDS on the AAA MBS were pooled and securitized and used to service new securities called synthetic collateralized debt obligations **(Synthetic CDO)** …

Pop Quiz 3 …

What Is The Fundamental Problem Here ?

Pop Quiz 4 …

What Do You Think Happened When The Housing Bubble Burst ?

And there was still more …

The CDS on the AAA MBS were pooled and securitized and used to service new securities called synthetic collateralized debt obligations **(Synthetic CDO)** …

Pop Quiz 3 …

What Is The Fundamental Problem Here ?

Way too much **leverage**

Pop Quiz 4 …

What Do You Think Happened When The Housing Bubble Burst ?

And there was still more …

The CDS on the AAA MBS were pooled and securitized and used to service new securities called synthetic collateralized debt obligations **(Synthetic CDO)** …

Pop Quiz 3 …

What Is The Fundamental Problem Here ?

Way too much **leverage**

Pop Quiz 4 …

What Do You Think Happened When The Housing Bubble Burst ?

Start with the pool of sub-prime mortgages and **“follow the money”** …

What Happened to Prices ?

Figure 3. ABX BBB– Price, 19 July 2006 to 3 August 2007

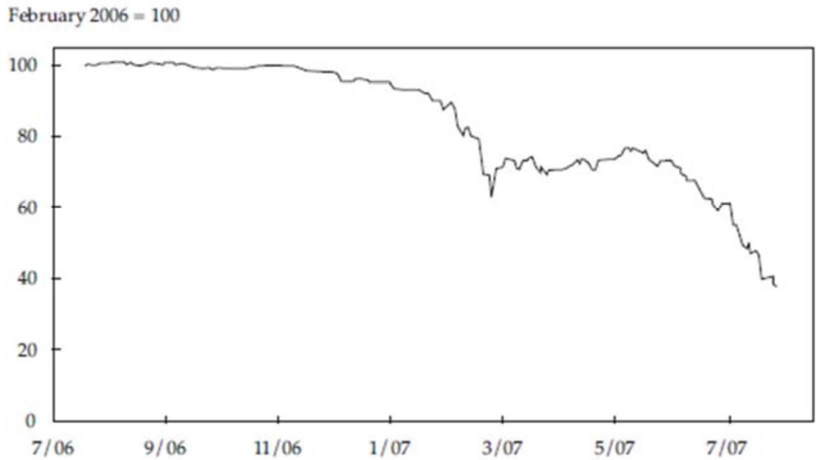
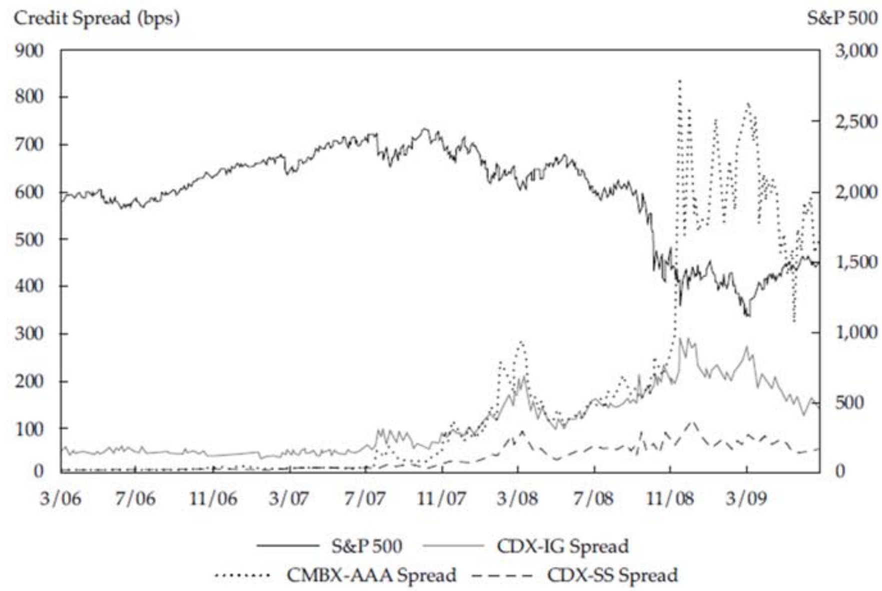


Figure 8. Credit Derivative Spreads and S&P 500 Levels, 6 March 2006 to 30 June 2009



Source: Daniel, K., 2009, Anatomy of a Crisis, CFA Institute Conference proceedings Quarterly, September.

- The ABX BBB- Index measures the price of sub-prime mortgages
- The CMBX-AAA measures the price of MBS AAA tranches
- The CDX-IG measures CDS spreads on investment-grade bonds

Who Was To Blame ?

Everyone is happy so long as the borrower continues to make the promised payments to the investor(s). But we had **multiple failures in the system** …

1. U.S. Government – a noble but **flawed policy**

2. (Some) Borrowers – sadly borrowed beyond their means

3. Rating Agencies – there were **flaws** in their **credit models**

   … **actual defaults** on the underlying sub-prime loans were high and **highly correlated**

   … homes could be sold to reduce the loss on a default but **recovery rates** on the loans that defaulted were **low** due to weak asset markets at the time

Pop Quiz 5 …

How Many MBS, CDO, CDO^2 Were Rated AAA ?

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Pop Quiz 5 …

How Many MBS, CDO, CDO^2 Were Rated AAA ?

60,000

4. Banks – **moral hazard**

   … securitization allowed the original mortgage lender to **pass on the credit risk** of the loan to someone else

5. Investment Banks – **flawed incentive** structures

6. Regulators – **too slow** to act

7. (Some) CDS sellers – **under-capitalized**

   … the CDS were sold by high credit quality firms such as AIG (one of the largest insurance companies in the U.S. … but this **did not eliminate the credit risk** faced by the AAA MBS investors

8. (Some) Investors – lack of a reality check

9. Leverage – lots of it !!

   *Warning: This clip from the movie – **The Big Short** – contains some bad language*

   https://www.youtube.com/watch?v=EEXTqtH-Oo4

The Aftermath …

> "After such a panic as has, the past year, swept over the country, it becomes a kind of melancholy pleasure to look over the field and find that there are not quite so many dead and wounded lying about as was anticipated. It was a fearful storm while it lasted … the result of an attempt to do too much with too little capital."

and …

> "It has not been simply the falling out of reckless traders – not the end of an ordinarily wild speculation in which the failure is usually the result of individual indiscretion and rashness … but it is more a result of a wrong financial system".

– Two editorials quoted in Giesecke, Longstaff, Schaefer and Strebulaev [1]

Key Takeaway

Never Forget About Risk

especially when times are good

[1] An earlier working paper version of: Giesecke, K, F.A. Longstaff, S. Schaefer and I. Strebulaev, 2011, Corporate Bond Default Risk: A 150-Year Perspective, *Journal of Financial Economics*.

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>
> **July 1874**

and …

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>
> **July 1876**

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<u>Is It Over ?</u>

There is still a problem in Greece …

“**Since the fall of 2009**, the European Union has been struggling with a slow-moving but unshakable crisis over the enormous debts faced by its weakest economies, such as Greece and Portugal, or those most battered by the global recession, like Ireland. A series of negotiations, bailouts and austerity packages have failed to stop the slide of investor confidence or to restore the growth needed to give struggling countries a way out of their debt traps.

– New York Times, 1 November 2011

“Greece is now expected to come under heavy pressure to accept, by mid-June, an agreement between its creditors to postpone further discussion about restructuring its €315 billion debt. That outcome would **keep Greece’s debt crisis on the back burner** until winter or possibly next summer

– Wall Street Journal, 24 May 2017

And perhaps another one is brewing in China …

"The chairman of China's biggest bank and a senior Chinese insurance regulator issued strong warnings on Saturday about the dangers of **shadow banking** to the Chinese economy, in the latest signs of growing top level concern here about a rise in highly speculative, poorly regulated lending"

– New York Times, 18 March 2017

"A major credit agency sounded the alarm on Wednesday, saying the steady build-up of debt would erode China's financial strength in the years ahead. The agency**, Moody's** Investors Service, **cut the country's debt rating, its first downgrade for the country since 1989**"

– New York Times, 23 May 2017

What to do After that Sinking Feeling…An Accounting story

Professor Naomi Soderstrom

THE UNIVERSITY OF MELBOURNE

What is an Accountant?

"No kidding! I really thought the term, '*bean counter*' was just a slang term."

What is Accounting?

Blurring of Internal/External Boundaries

1. **Management positions (CFO, audit manager, managing partner) require in-depth understanding of managerial control systems, which are designed to help implement strategy**

2. **External auditors today are seeking the internal management reports to 'see' behind the numbers in the financial statements**

3. **Shareholders are increasingly demanding control over internal decision processes/incentive systems**

4. **Financial Reporting is taking on a more "Integrated Perspective"**

Mazda: What to do about that Sinking Feeling

Mazda is a Japanese auto manufacturer that is 33.4% owned by Ford Motor Company.

In late July, 2006, Mazda was informed that a containership carrying over 4,700 vehicles had been involved in a mishap en route to Canada and the US.

Following US marine law for ships coming from international waters, the ship's crew went through the exercise of purging ballast tanks of seawater that had been taken on in foreign lands.

In this case, however, the starboard ballast tanks were drained without being refilled simultaneously with local seawater. This caused the ship to keel over. The ship remained afloat, but was resting in the water on its side at a 60 degree angle.

That Sinking Feeling

NEWS FROM MAZDA

For Your Information

2006/07/27

Mazda Vehicles Aboard Stricken Car-Carrying Vessel, Cougar Ace

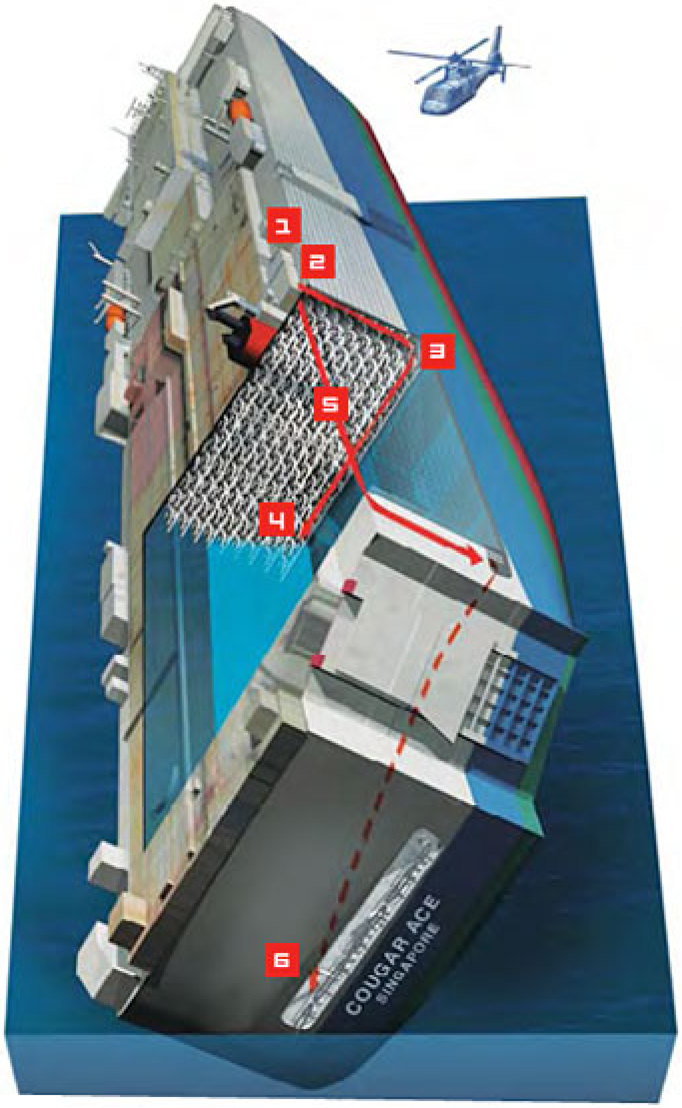
On July 24, 2006, Mazda was advised that the Mitsui OSK Lines' *Cougar Ace* had run into trouble off the Alaskan coast. Although it is reportedly still afloat, the vessel is on its side.

What caused this incident or the extent of the damage to the vehicles is currently unknown. Just over 4,700 Canadian- and U.S-bound Mazdas were on board. Approximately 60 percent of the cars are MAZDA3s and close to 30 percent are Mazda CX-7s. The vehicles were headed to the ports of Vancouver (Canada), Tacoma and Hueneme in the USA.

A plan for salvaging the vessel is being developed and will be executed by Mitsui OSK Lines as soon as possible.

Mazda will wait until the situation has been fully evaluated and understood, before disclosing further information.

http://www.mazda.com/publicity/release/2006/200607/060727a.html



Recovery of the ship:

- Recovery effort took 3 weeks and cost the shipping company US$10m.
- Very dangerous operation where one salvage operator was killed
- On initial inspection, all Mazda vehicles were still strapped & in place.
- However salvage team were concerned that if one car snapped free, it would start an “avalanche” of cars that would injure the team & potentially sink the ship
- Cougar Ace finally made it to port at Oregon on August 12, 2006.
- 99% of its cargo was intact. The ship was recoverable and afloat. There was no environmental disaster.

What about the cars????

Inventory on Board:

- 2,804 Mazda 3s
- 1,329 Mazda CX-7s
- 295 Mazda MX-5s
- 214 Mazda RX-8s
- 56 Mazda 5s
- 5 Mazdaspeed 6s.
- 109 small commercial trucks (not Mazda owned)

- Autoblog estimates that value of the vehicles is $US 103 million (roughly $US 22,000 per car)

What about the cars????

- Mazda HQ were fielding hundreds of calls from new car buyers wondering if their car was on the Cougar Ace
- The company received hundreds of calls from people all over the world looking for cheap cars.
- They also received calls from Fire departments, Hollywood producers, charities, driving instructors seeking the “damaged” cars.

- If the Cougar Ace had simply sunk to the bottom of the ocean, all Mazda would have had to do was ring the insurance company and bank the cheque.
- However, Mazda now faced with a major problem of what to do with the remaining 4,635 “apparently new” cars

Disclosure Timeline

24 July 2006

Mitsui OSK Lines informs Mazda of the accident

27 July 2006

Mazda issues a press release saying Mitsui is developing salvage plans and Mazda will wait until the situation is fully evaluated and understood before disclosing further information.

27 August 2006

Mazda spokesman Jeremy Barnes is quoted as saying "We don't have a car count as to what is saleable and what condition they are in. It all depends on what we find when we get in."

15 December 2006

Autoblog indicates that Mazda had said earlier that it would inspect all the vehicles and sell most as "used with full disclosure", considering that many showed little or no signs of damage.

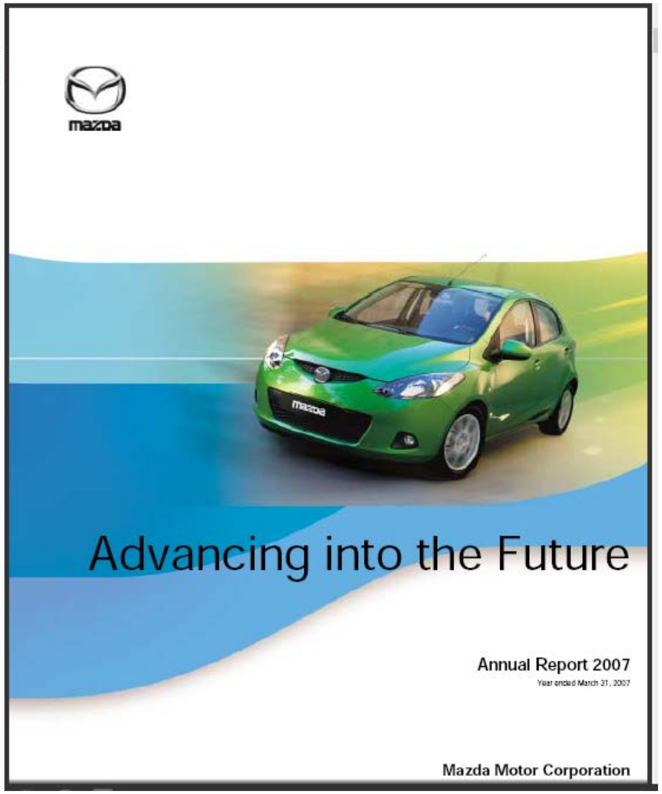
However, on the same day…

Mazda issues a press release saying that all Cougar Ace vehicles will be destroyed.

Disclosure Timeline

2007 Annual report (April 2007)

Mazda recognizes ¥1.979 billion (US$16.76 million, or $US 3,566 per vehicle) *inventory* valuation loss in Other Income.



Disclosure Timeline

29 April 2008

Wall Street Journal publishes article on Mazda's "disassembly" line, describing the loss of approximately $US100 million worth of cars.

6 May 2008

The last Cougar Ace Mazda is reported to be shredded.*

8 May 2009

Court case Mazda and Indemnity Insurance Company of North America vs. M/V Cougar Ace. Lawsuit cites $US40 million water damage. The court decides that any claims need to be adjudicated in Japan.

*** Note that the cars were parked in a shipping yard in Oregon, untouched for 19 months before the shredding process began.**

What to do?

While Mazda eventually decided to destroy all of the cars, they initially considered the alternative of selling or donating the cars. How did they make this decision?

Steps for Making Decisions

Recognize the need for a decision

Generate Alternatives

Assess Alternatives

Choose Among Alternatives

Implement the Chosen Alternative

Analyse Feedback

Generate Alternatives

Primary Alternatives:

- Sell the cars at a discount
  - Individuals
  - Movie Companies
- Donate the cars
  - Schools
  - Fire Departments
- Destroy the cars

Steps for Making Decisions

Recognize the need for a decision

Generate Alternatives

Assess Alternatives

Choose Among Alternatives

Implement the Chosen Alternative

Analyse Feedback

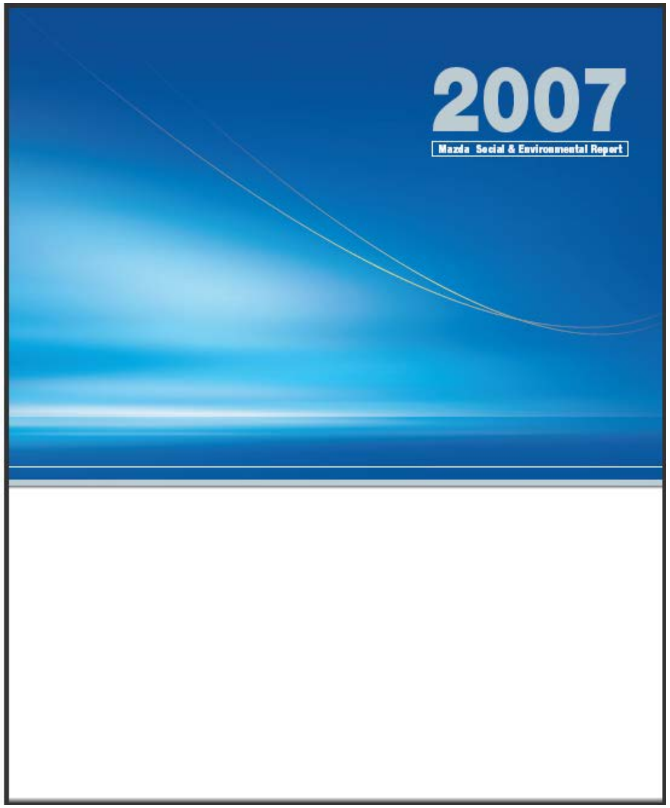
Assess Alternatives

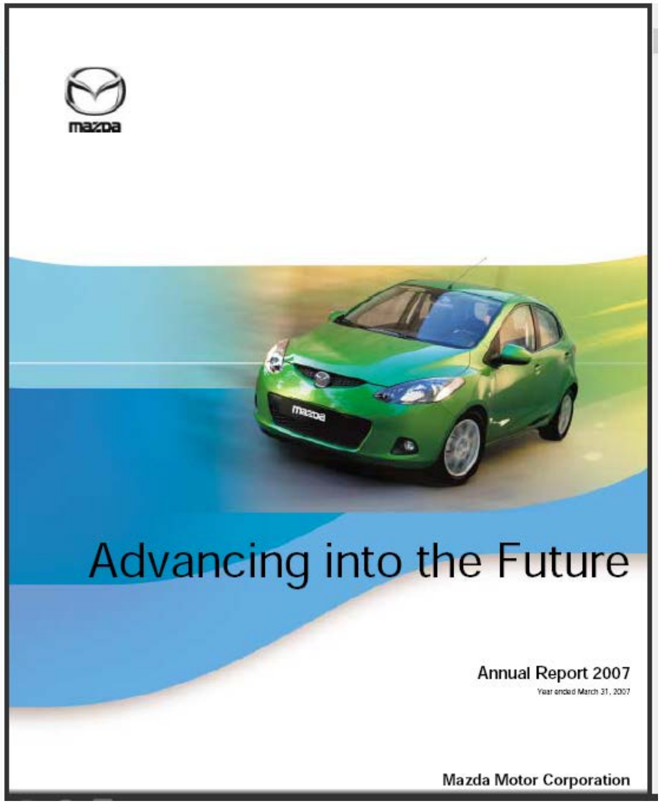
Consider both quantitative and qualitative aspects!

- Sell the cars at a discount
- Donate the cars
- Destroy the cars

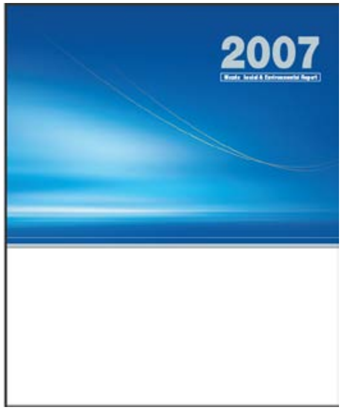
Clearly, in the decision the potential liability dominated!

What can we learn about the incident from looking at financial and other reports produced by Mazda?





The Corporate Social Responsibility (CSR) report for 2007 does not include any mention of the incident, although it includes discussion of overseas shipping of finished vehicles, recycling of vehicles, and resources recovered.

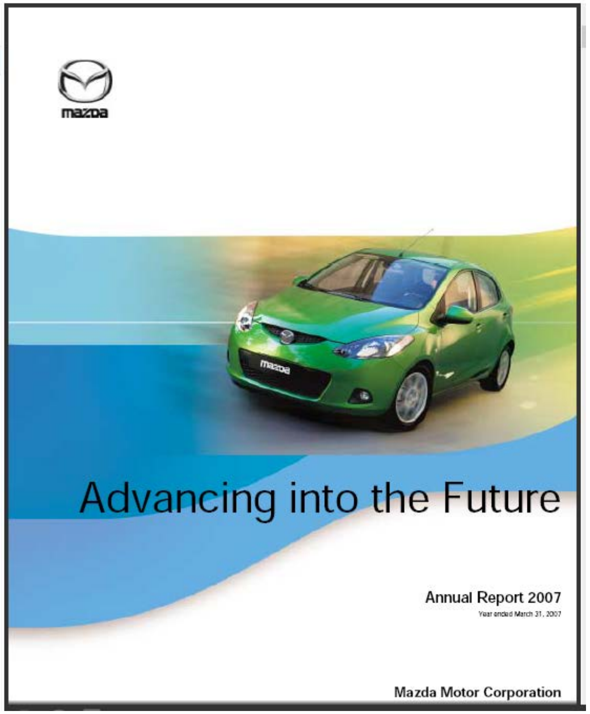


How can they get away with this?

- **CSR reports are voluntary**
- **There is no standard disclosure**
- **CSR reports do not have to be audited**
- **"….These comments do not constitute a judgment on whether this report presents accurate measurements and calculations, has any major omissions, or was prepared in accordance with generally recognized fair and appropriate production standards for environmental and other reports." Third-Party Opinion statement, Mazda 2007 CSR report**

Financial Statement Disclosure

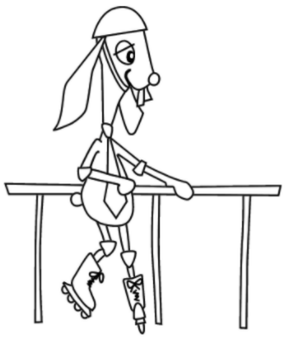
Mazda made the decision to destroy the cars by the end of fiscal year 2007, but the cars were not completely destroyed until two years later. How should the incident and its aftermath be reflected in the financial statements?



Accounting Conservatism

- **Financial Reporting generally employs a "conservative" approach**
  - **Bad news is recognized early**
  - **Good news is recognized later**

Accountants' error on the side of caution



GAAP Bunny is not taking any chances here

- **What should we see?**
  - **Write-down of inventory**
  - **Provision (liability)**
    - Is the liability probable?
    - Is the liability reasonably estimable?
    - If yes to both, there should be a liability recognized

However, we don’t see a liability

Is it because there is insurance covering the loss?

- **Remember that accounting is conservative**
  - The threshold for recognizing an insurance recovery is much higher—it must be virtually certain, but if it is probable, it can be included in a footnote
  - Disclosure of the liability and any recovery should be separate (not netted)
  - So…we should see a separate disclosure for the disassembly liability and the insurance recovery.

What do we see?

- **There is no separate disassembly liability**
- **There is no footnote concerning the expected insurance recovery—indeed, the financial statement includes no insurance claim income or insurance proceeds received for 2007 or 2008.**

Why were they able to get away with this?

Japanese GAAP

Although Japanese accounting standards are similar to those used in Australia, the rules are much more loose. However, even under Japanese accounting rules, a liability that is “highly probable” should be disclosed. The insurance recovery should have been included in the financial statements once it was received.

Who is the final arbiter for the disclosures? The auditor!

Overall, the strategy was to minimize disclosure of the incident, and the auditor did not demand increased disclosure. If Mazda were an Australian company, reported income would have been lower than was actually reported.

This is clearly not the whole picture. The picture is much more complex and interesting if you dive into the accounting!