street wise

BY STEPHEN BARLAS, JIM CHAMBERLAIN, BOB RANDALL, CURT VERSCHOOR, KATHY WILLIAMS

[NEWS]

William Donaldson Is New SEC Chair | Kathy Williams, Editor

LAST MONTH, WILLIAM H. DONALDSON, 71, WAS SWORN IN AS THE NEW chairman of the Securities & Exchange Commission, replacing Harvey L. Pitt, who resigned in November 2002. The former head of the New York Stock Exchange and co-founder of investment banking firm Donaldson, Lufkin & Jenrette, pledged to be a vigorous enforcer and to protect small investors.

"We will hold accountable all those who have violated the public trust," Donaldson said at the swearing-in ceremony. "We will demand responsible corporate governance throughout the business and financial world."

During his Senate confirmation hearings, he also said his first priority was to name the chairman of the Public Company Accounting Oversight Board (PCAOB) created by Congress in July 2002 as part of the Sarbanes-Oxley Act.

Donaldson also was president and CEO of Aetna Inc., chairman and CEO of Donaldson Enterprises Inc., and a founder and the first dean of Yale University's Graduate School of Management. A U.S. Marine in 1953-55, he served in Japan and Korea.

He holds a B.A. degree from Yale and an MBA degree from Harvard and is a chartered financial analyst (CFA).

Superior Employee Practices Create Greater Shareholder Value

Companies with superior human capital practices have better total returns to shareholders or growth in shareholder value, according to Watson Wyatt's latest Human Capital Index® studies in North America, Europe, and the Asia-Pacific.

Here are the practices that generate the most value:

- Clear rewards and accountability—broad-based stock ownership, paying above market, effective performance management.
- Excellence in recruitment and retention—effective recruiting processes, a positive employer brand, focus on key skills retention.
- Collegial, flexible workplace—employee input into how work gets done, higher trust in senior management, lack of workplace hierarchy.
- Communications integrity—effective use of employee surveys, sharing of strategy and financial data with employees, employee input into decision making.
- Focused human resources technology—using technology to improve service and accuracy or to cut costs. ■

FASB SETS UP USER ADVISORY COUNCIL

To increase the investment community's participation in the accounting standards-setting process, the Financial Accounting Standards Board has established a User Advisory Council made up of 35 professionals representing a variety of investment and analytical disciplines.

The group will help the FASB raise awareness of how investors and investment professionals, equity and credit analysts, and rating agencies use financial information.

Council members will serve as a resource to the Board in formulating its technical agenda and on specific projects the Board undertakes. According to the FASB, Council meetings will concentrate on major FASB projects that could significantly change financial information currently available to users. ■

READERS' INPUT

MORE ON VALUATIONS

I enjoyed the article "Business Valuation Made Simple" by David S. Harrison in the February issue. He took a complicated subject and broke it down into its basic components. However, I would like to add to his paragraph regarding "Project Future Cash Flows," Step 2.

In addition to the identified change in ownership issues, care must be taken to factor in any additional investments required by the new owners. Frequently, many businesses are "harvested" or not maintained by their owners prior to sale. Capital investment may have lagged during the past few years. New or added capital investment may be required just to maintain historical cash flows. This may significantly reduce the valuation of the firm and is an important factor to consider.

James M. Chamberlain, CMA

We welcome all opinions on articles and departments published in Strategic Finance. *E-mail correspondence to Kathy Williams at kwilliams@imanet.org.*

[ETHICS]

Are "Whistle-Blowers" Heroes or Just Doing Their Job?

by Curtis C. Verschoor, CMA, Editor

FIVE INDIVIDUALS HAVE BEEN SINGLED OUT FOR PUBLIC PRAISE AND admiration because they took great personal risks in order to "blow the whistle" on actions in their organizations that they considered unethical or illegal. During the year they had already received generous media publicity because of the strength of their character and willingness to speak up. At year-end, three were named as 2002's "Persons of the Year" by *Time* magazine. Two of them were also included in the four praised as whistle-blowers by *Business Week* magazine.

Who are these four women and one man of courage who believed so strongly in their principles? Why were they so motivated to risk jobs they cared for, their privacy, and their mental outlook to tell the truth when no one else came forward to do so? *Time* calls them the counterparts of the NYPD and FDNY heroes of 2001. None of them said they sought or even seemed to foresee the intense public notice their actions would bring about. Their motivation was only to do the right thing for an organization to which they felt a responsibility.

In four of the five cases, these brave persons presented their criticisms only in-house and made no attempt to make them public. Thus, the four women were not whistle-blowers in the strictest sense of the word. The appearance of their stories in headlines was a result of leaks to the media by others. In the fifth case, the person warned his employers before contacting regulators.

Only *Time*'s coverage was sufficiently in depth to consider questions of "Who were these brave women?" and "Why did they do what they did?" Their upbringing included amazing similarities that fostered an attitude of independent thinking. Each decided to challenge higher-ups in a culture of silence and cover-up.

Sherron Watkins was the vice president at Enron who wrote to Chairman Ken Lay expressing concern that Enron's accounting should be investigated because it seemed to be shaky. The trigger for Watkins' memorandum was an invitation by Lay to put any concerns into a comment box. Apparently, she was the only one to comment in spite of a quotation from Martin Luther King, Jr., that Enron had widely publicized. King noted: "Our lives begin to end the day we become silent about things that matter." Earlier in life, Watkins complained her classes got inadequate attention from a Lutheran school principal who also had to teach both the seventh- and eighth-graders. Her action was credited with a decision to divest one of his duties, and he later left the school.

Coleen Rowley was the staff attorney at the Minneapolis office of the FBI who wrote to FBI Director Robert Mueller expressing her concerns that her office's attempts prior to September 11 to further investigate Zacarias Moussaoui (later charged as co-conspirator of the terror attacks) had been largely ignored. As a young girl, she had the courage to tell teachers when they were wrong or unclear, but always after school, never during class. Rowley just wanted to help her classmates learn the material correctly. She had to put herself through college because her bluntness cost her a scholarship.

Cynthia Cooper, as the vice president of internal continued on page 4

[GOVERNMENT]

Changes to Bush Stimulus Package Unavoidable | Stephen Barlas, Editor

THERE IS NO CHANCE CONGRESS is going to give President Bush all of his $670 billion in tax cuts, despite the fact that the Republicans control both the House and Senate. Senate Democrats are pushing a much smaller package with considerably different components. And Bush will have to compromise with Democrats because he will need support from at least nine of them if he wants to get the 60 votes needed (there are 51 Republicans) to cut off a filibuster by Democrats who may want to keep a bill from emerging from the Senate. For corporations, the Bush plan offers relatively little beyond ending the double taxation of dividends, which the President sees as a way to jolt the stock market and, thereby indirectly, corporations. But some dividends would continue to be taxed, and companies would have to set up complicated new recordkeeping systems to report what the President's plan refers to as "excludable distribution accounts," which are dividends that can't be taxed.

The Democratic stimulus plan offered by Sen. Max Baucus (D.-Mont.), top Democrat on the Senate Finance Committee, does offer one corporate tax incentive: increasing from 30% to 40% the additional "bonus" depreciation that companies can claim in the first year after they have purchased a new piece of production equipment; that bonus depreciation was authorized by Congress in 2002 and lasts for a temporary three-year period starting September 10, 2001. Interestingly, neither the Bush nor the Baucus plan includes a temporary suspension of payment of payroll taxes by employees and employers, which had been the hottest stimulus idea around at the end of 2002. Business groups such as the Business Roundtable, which represents *Fortune* 500 compa-

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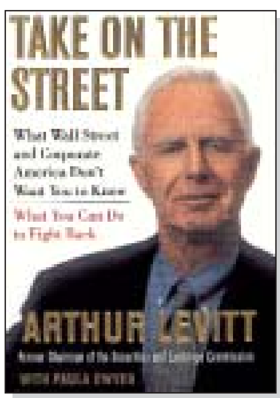
BOOKS

Former SEC Chairman Levitt Speaks Out

✷ **WHO WOULD KNOW MORE ABOUT THE** machinations of Wall Street than the quintessential insider Arthur Levitt, who worked as a broker and then as president of Shearson Hayden Stone brokerage before President Clinton appointed him chairman of the Securities & Exchange Commission in 1993? He was very successful at Shearson, which eventually became part of Citigroup, but had a conscience. That's what led him to become a champion for the small investor and to write *Take on the Street*, published by Pantheon Books, New York.



As you might have guessed, the title has a double meaning, capturing a description of the Street's methods of making money and the author's view of its modus operandi and how he labored to change it. "While I am proud of helping to build one of America's largest and most distinguished brokerage and investment firms—and remain friendly with most of my partners and co-workers—I grew uncomfortable with practices and attitudes that were misleading and sometimes deceptive."

Change, he discovered, did not come easy. Pressure from business CEOs, lobbyists, and members of Congress forced him to ask the Financial Accounting Standards Board (FASB) to back down on its proposal to require companies to count stock options as an expense on the income statement. He laments, "I regard this as my single biggest mistake during my years of service."

A zealous reformer, Levitt

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[GOV'T] *cont'd from p. 3*
nies, had supported payroll tax relief.

AICPA Wants Changes in Records-Retention Rule

The American Institute of Certified Public Accountants (AICPA) wants the Securities & Exchange Commission to make some changes in its proposed rule regarding retention of records relevant to audits and reviews of issuers' financial statements. One of its major concerns is the opaqueness of the "other documents" that auditors are expected to hang onto as part of any audit. The AICPA wants audit committees to get more information from auditors, not less. But if too many things are defined as "other documents," auditors will be reluctant to place preliminary conclusions, opinions, or analyses in writing, thus creating documents that they'll be required to retain. Consequently, the AICPA recommended that the definition of "other documents" be more clearly described as "documentation of significant differences in professional judgment arising during the audit on issues that are material to the issuer's financial statements or to the auditor's final conclusions regarding the audit or review."

Corporate Counsels Want Changes, Too

Should in-house and outside attorneys have to inform the SEC that a company they work for is about to report an inaccurate financial statement? That's what the SEC wants and groups such as the American Bar Association and Business Roundtable oppose. The latter don't want corporate lawyers turned into police. Instead, they say a lawyer should stop representing the derelict company. In its view of this Sarbanes-Oxley provision, however, the SEC believes a lawyer should also tell the SEC of the impending corporate misdeed and report it all the way up the corporate chain-of-command, ending with the board of directors.

Bigger Criminal Penalties for Securities Crimes

Federal court judges will start imposing tougher criminal penalties on corporate officials who "substantially jeopardize" the health of a publicly traded company. The U.S. Sentencing Commission, whose guidelines are used by federal judges, established new guidelines in response to a requirement in the Sarbanes-Oxley law. Corporate officers, for example, could be sentenced to a minimum of 10 years in prison as a result of a million-dollar fraud as opposed to a current minimum of five years. But the Justice Department was disappointed with the new guidelines because the tougher penalties don't extend to lower-level corporate officials. It will ask Congress to pass legislation correcting that oversight. ■

[ETHICS] *cont'd from p. 2*
audit at WorldCom, ignored her boss's wishes and unearthed hundreds of millions of dollars of accounting irregularities. Like her fellow Persons of 2002, Cooper is thought of as single-minded and tenacious. Despite her college classmates' disdain, she would fire questions at her professors from her first-row seat even near the end of the class period. An elementary teacher complained that Cynthia would prefer to stay inside to talk with the teachers instead of going outside during recess.

So, what do these women have in common? Each of the three grew up in small towns with values honed in the middle of the country. Each is a first-born child in a family that had modest means, even living paycheck to paycheck at times. All three are married with children and serve as the main source of income supporting their family. In fact, two have spouses who are stay-at-home dads, thus increasing the pressure to protect their careers.

And what are the three doing now that the confidential information they wanted to get addressed by higher-ups is well known by many outside their organizations? Watkins decided to forgo her $165,000 salary, go on the speaking circuit, and coauthor a book. Cooper and Rowley are still with the same employers. Cooper has been given more staff and more money; Rowley has been hit by a nasty backlash within the FBI and from former agents.

A major cause of every whistleblower's fight to be heard is that the culture of their organization does not foster open discussion of differences. This was also true for those who spoke up in 2002. The important question is: "Can a more open culture having greater trust encourage the dialogues that make whistleblowing unnecessary?" I believe the answer is, "yes."

Does the culture in your organization need to be evaluated? Perhaps your Code of Conduct or its administration may need revision. ■

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[BOOKS] *cont'd from p. 3*
faults brokers, analysts, CEOs, and Congress for "sticking" it to the small investor. He says the game was rigged before many of the reforms he championed were put into effect. Some brokers and analysts did not work primarily for the investors. Instead, they traded and offered advice designed to increase their own and their company's bottom line.

He is proud of the SEC's Regulation Fair Disclosure, or Reg FD, that required companies to release important information to all investors at the same time, noting that "selective disclosure" had gotten out of hand in the 1990s. The SEC overcame significant opposition from the securities industry in achieving this victory.

The chapter titled "The Numbers Game," which details the fight over stock options and the FASB, will be of special interest to IMA members. Levitt fought to increase the number of independent trustees on the Financial Accounting Foundation (FAF) and was strenuously resisted by the FAF's constituent groups. Another knock-down battle over the rule that would affect accounting firms' consulting with their audit clients elicited a threat from Arthur Andersen's CEO: "Arthur, if you go ahead with this, it will be war." Levitt's comment on the rise and fall of the American Institute of Certified Public Accountants' Public Oversight Board is blunt: "The lesson of this episode is crystal clear: self-regulation by the accounting profession is a bad joke."

This frank, well-written testament of a crusading regulator zeroes in on the practices that helped to bring about the accounting debacles at Enron and WorldCom. What Levitt seems to be saying is, "See, if you listened to me and enacted all my proposed reforms," much of this would never have happened. True to his stated purpose, the book is investor friendly, with many technical terms explained very thoroughly and cogent investment advice offered. The letters Levitt includes in the "Power Games" appendix may well be worth the price of the book alone, as U.S. senators and representatives—and even Enron's former CEO—are seen lobbying the SEC's chairman against proposed reforms.—*Bob Randall*