streetwise

BY STEPHEN BARLAS, JEAN-VICTOR CÔTÉ, DARYL FRANCIS, KYLE KRAFT, CURT VERSCHOOR, KATHY WILLIAMS

[NEWS]

Leslie Seidman Named to FASB; Gary Schieneman Reappointed | Kathy Williams, Editor

IMA MEMBER LESLIE F. SEIDMAN, CPA, HAS BEEN APPOINTED TO A THREE-year term on the Financial Accounting Standards Board beginning July 1, 2003. She will complete the term of John K. Wulff, who resigned from the Board, effective June 30, to return to private industry. The Financial Accounting Foundation (FAF) also reappointed Gary S. Schieneman as a Board member beginning July 1.

At present, Seidman is the managing member of Leslie F. Seidman Consulting, LLC, which provides consulting services to global financial institutions and major corporations. Before forming her firm in 2000, she served the FASB in various capacities, first as an industry fellow, then as a project manager. Later, she was promoted to assistant director of research, concentrating on industry issues. In this capacity she managed the activities of a team of practice fellows sent to the FASB from various firms for two-year assignments.

Leslie F. Seidman, CPA

Before this, Seidman was vice president, accounting policy, at J.P. Morgan & Company, where she worked from 1987 to 1996. She started her career in accounting at Arthur Young & Co. in New York City in 1984 after graduating from Colgate University with a B.A. degree in English. She later earned an M.S. degree in accounting from New York University. In 2002, she wrote *Miller Financial Instruments*, a manual for accountants and other professionals.

Regarding her FASB appointment, Leslie Seidman said, “In these challenging times, we need accounting standards that practitioners can understand and implement. I hope to maintain regular contact with IMA members and bring the industry perspective to the Board table.”

Gary Schieneman, who completed the term of outgoing member Anthony Cope, joined the FASB in July 2001 from Merrill Lynch & Co., where he served as director of comparative global equity analysis. ■

JOB NEWS GOOD FOR ACCOUNTING GRADS

Most business graduates are finding jobs and at higher salaries than other graduates, according to the spring 2003 salary survey conducted by the National Association of Colleges and Employers (NACE), a Bethlehem, Pa.-based organization that provides information to college career services practitioners and human resource professionals.

On average, starting salaries for business graduates rose 3.7% from 2002 to $36,515, those for accounting graduates rose 2.6% to $41,360, and those for economics and finance majors rose 1.8% to $40,764.

Accounting graduates were offered, on average, $42,145 for private accounting jobs, $42,191 for public accounting jobs, $45,680 for consulting, and $45,761 for financial analyst positions. ■

SUPERIOR CORPORATE PERFORMANCE IS RELATED TO A SET OF ETHICAL VALUES

READERS' INPUT

THE NEW AIA

I read with interest the News item [April 2003] on the newly formed AIA [Association for Integrity in Accounting] and their desire to eliminate the FASB and inject themselves and the government in setting new accounting policies. With their ties to Ralph Nader, I cannot help but suspect that they have political motives. Is anyone else afraid that this group will be more concerned about political agendas than a desire to improve accounting rules and regulations?

Kyle Kraft, CMA, CPA
Director
Structural Metals, Inc.

INTRANET BUDGETING

I just read [the] article on Web-Based Budgeting [May 2003]. It sounds like it was a monumental project that has been very rewarding since completing the first phase. I think [they] have a program that is very efficient and fulfills the needs of management. That is very good.

Daryl Francis
Budget Specialist
Hanford Environmental Health Foundation

[ETHICS]

Ethical Corporations Are Still More Profitable | by Curtis C. Verschoor, CMA, Editor

IT'S REFRESHING TO READ THE RESULTS OF NEWER RESEARCH THAT REPLICATES a conclusion about which I have long been convinced: Large corporations that display a commitment to ethical behavior have superior long-term financial performance.

The Institute of Business Ethics in the U.K. has published *Does Business Ethics Pay?*[1] This research study compares the financial performance of two groups of companies: those with a demonstrable commitment to ethical behavior and those without. The research used several measures of performance that extended over a five-year period. It reprinted my research of U.S. companies published in 1999 as an appendix.

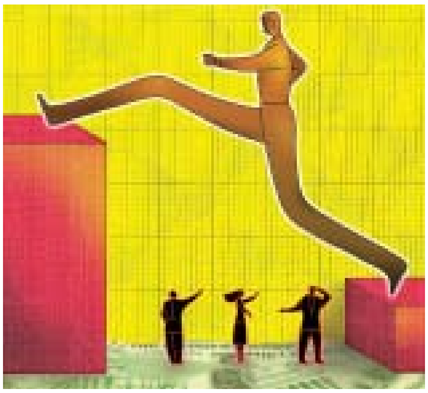

ILLUSTRATION: KEN ORVIDAS/ARTVILLE

Using consultant Stern Stewart's metric of annual profitability, economic value added (EVA®), the ethical companies outperformed the others in four of the five years. Using its calculation of market value added (MVA), a measure of long-term wealth creation for shareholders over time, the performance gap was even more marked. Comparison of the price/earnings ratios of the two groups showed that the market price of the ethical companies was far less volatile than that of the others.

On the measure return on capital employed (ROCE), the results were mixed, with the ethical companies underperforming from 1997 to 1999. The trend then reversed so that the ethical companies were clearly superior performers on this metric from 1999 to 2001.

The research used other measures to validate the genuineness of the ethical companies' commitment and found strong proxy indicators. These included higher rankings on Britain's Most Admired Companies list, published in the U.K. by *Management Today*. This is a nine-factor analysis of opinions from corporate peers and industry experts. It is similar to the Most Admired Companies research performed by *Fortune* in the U.S.

Another proxy indicator was a better rating on risk management for the ethical companies. These ratings are regularly performed by the SERM Rating Agency Ltd, an independent environmental rating agency that calculates, in financial terms, the direct and indirect percentage risk to capital a company faces from potential environmental, safety, and social impacts. Using 32 different social and environmental risk factors, it quantifies inherent and residual risk to market capital.

The U.K. Institute concurs with the U.S. conclusion that superior corporate performance is related to a set of ethical values—and the behavior resulting from those values—that are infused into a company over time. We both believe that a code of ethics is a reflection of those values and behaviors, not a driver of them. The Enron experience proves the insufficiency of merely having a code and not living by it.

The U.K. research chose as its main measure of financial performance the Stern Stewart-calculated economic value added

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[GOVERNMENT]

Credit Agencies in Congressional Crosshairs

Stephen Barlas, Editor

NOW THAT THE SECURITIES & Exchange Commission is getting near the end of the road on Sarbanes-Oxley (S-O) rulemakings, Congress is putting together an agenda for post-Enron "unfinished business." Credit rating agency reform will definitely be on the final list. The SEC submitted to Congress in January an S-O-dictated report on the four "nationally recognized statistical rating organizations," or "NRSROs," which are recognized by the SEC. They are: Moody's Investors Service, Inc.; Fitch, Inc.; Standard and Poor's, a division of The McGraw-Hill Companies Inc.; and Dominion Bond Rating Service. Annette L. Nazareth, director of the division of market regulation at the SEC, laid out the indictment against the credit rating agencies to the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises on April 2. The report identified a number of important substantive issues related to credit rating agencies that the Commission would be exploring in more depth, including the following: (1) improved information flow in the credit rating process; (2) potential conflicts of interest; (3) alleged anticompetitive or unfair practices by NRSROs; (4) potential regulatory barriers to entry into the credit rating business; and (5) ongoing regulatory oversight of credit rating agencies. The SEC will be issuing a Concept Release in the near

Potential conflicts of interest are high on examination list.

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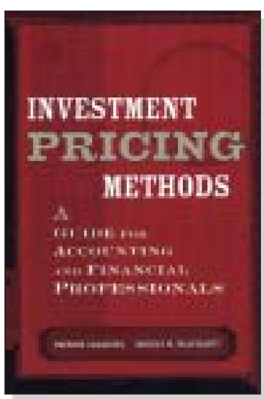
BOOKS

Finding the Value of Financial Investments

✷ **VALUING AND PRICING FINANCIAL INVESTMENTS** can be difficult for any financial or accounting professional. In their book, *Investment Pricing Methods*, Patrick Casabona and Robert M. Traficanti provide a basic understanding of the various methods used. According to the authors, "The purpose of this book is to familiarize accountants with pricing methods commonly used by investment analysts rather than to provide a complete guide to prepare investment valuations." They also make clear, however, that "in no event should one interpret this volume as establishing accounting guidelines for investment pricing."



Casabona and Traficanti cover many of the common financial investment instruments. Fixed-income securities get the lion's share of this book, with mortgage-backed and asset-backed securities occupying a fourth of it. The authors also provide an introduction to securitization, a hot topic in finance; derivatives (and hedging), with an extensive coverage of swaps; and various examples of both fair-value hedges and cash-flow hedges.

The book has a hands-on, computation-intensive slant. Formulas aren't derived—they're stated. Many real-world examples are given that cover a number of special cases. Procedures for using the HP12C financial calculator for fixed-income security pricing are given. Key valuation concepts are discussed without delving deeply into high mathematics or abstract

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[ETHICS] *cont'd from p. 22*

because it reflects internal performance and isn't influenced by external factors like the stock market. It's true that EVA is most valuable to management. But I continue to believe that the preferable measure is Stern Stewart's calculation of market value added, or the excess available to shareholders over what they have invested over time. MVA views a company from the perspective of an investor. EVA can help management make better business decisions, and MVA can help motivate better investment decisions.

Only a few individuals are able to make the necessary changes needed to infuse an ethical culture into an organization. Rewarding a company by making an investment in it because of its superior financial performance and its serious consideration of social and environmental responsibilities, however, is an action that many of us can take. Mutual funds that limit their portfolios to ethical—and thus socially and environmentally responsible—companies are also available.

The U.K. research clearly shows that ethical companies have superior financial performance over periods of time. Preliminary results of later research in the U.S. show that this result is taking place in this country as well. ■

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[1] Simon Webley and Elise More, *Does Business Ethics Pay? Ethics and Financial Performance*, The Institute of Business Ethics, London, 2003.

[GOV'T] *cont'd from p. 23*

future asking for public comment, but the House subcommittee hearings were a preview of what those comments might look like. James A. Kaitz, president and CEO of the Association for Financial Professionals, pretty much affirmed the SEC's analysis of credit rating agency weaknesses. Citing an AFP survey, he said 73% of corporate practitioners believe that the SEC should periodically review the rating agencies it currently recognizes—for example, every five years. Rep. Michael Oxley (R.-Ohio), chairman of the full House Financial Services Committee, made this telling statement: "The similarities between the potential conflicts of interest presented in this area and those that were addressed in the area of accounting firms in Sarbanes-Oxley are impossible to ignore."

SEC Fires Warning Shot at Audit Committees

But before Congress gets to credit rating agencies, there's still unfinished Sarbanes-Oxley business, a fact underlined by the SEC's adoption of new rules to ensure that the members of audit committees on corporate boards aren't in management's pocket and that they exercise fastidious attention to corporate financial statements. Companies that ignore the rules will get tossed off U.S. stock exchanges. The first requirement is that a member of an audit committee has to be "independent," a term defined in the rule. The committee must make the final call on who the independent auditor is, come up with procedures to protect whistleblowers, and hire independent counsel if it smells something bad happening. The corporation, meanwhile, must make sure the committee has the funds it needs to do all these things. As to what constitutes "independence," the SEC establishes two key criteria: audit committee members can't accept any consulting, advisory, or compensatory fee from the issuer or any subsidiary beyond what they receive for their board work, nor can they be "an affiliated person" of the issuer.

Chief Accountant MIA

Now that Jackson M. Day has left the SEC, the chief accountant's office is really empty. Day had been the acting chief accountant since Bob Herdman left in November 2002. Herdman wasn't replaced at the time, maybe because Harvey Pitt, then SEC chairman, was on his way out. Now that William Donaldson, Pitt's replacement, has taken the chairman's seat, the search for Herdman's replacement can begin. But, in the meantime, finance professionals have to wonder about the impact of the lack of leadership in the chief accountant's office.

Langdon Gone from IRS

Larry Langdon, who served as commissioner of large and mid-sized businesses (LMSB) at the IRS for the past three-and-a-half years, is another key regulatory official who has just left his job. Lauding Langdon at a meeting put on by the Tax Executives Institute at the end of March, Pam Olson, the assistant secretary of the treasury for tax policy, said the IRS now must follow up on Langdon's last initiative—limited issue focus examinations. Among the questions that must be answered are: "Who should be audited, how should they be audited, and what should be audited?" ■

[BOOKS] *cont'd from p. 23*

generalizations. (Distinctions are usually made clearly, except that most of the references to duration in the book are, in fact, references to modified duration. Both are defined there.) Various securities are illustrated mainly through the use of worksheets that should be easy to reproduce with electronic worksheets. There is also a companion downloadable PowerPoint presentation that includes about 350 very comprehensive slides.

Almost all exhibits in the book are presented well, but most of the appendices are extensions of the material in the text and sometimes require familiarity with concepts and terminology that aren't covered here. They could be valuable, but you first need to use the material from the book in the field for a while. Clearly, Casabona and Traficanti aim to position the reader to explore more in-depth material.

Overall, this book will help you perform reasonableness checks on the fair value of most financial assets (and commodity futures) and help you exercise professional judgment about the corresponding public and private placements. It will help implement fair value measurement accounting guidelines for financial instruments and introduce you to hedge effectiveness, a central issue in accounting for derivatives. It is a good starting point if you are new to capital markets, especially if you're comfortable learning by example. It also will provide you with some of the prerequisites for risk management. Finally, one of the added values for accountants is that "there is no conflict between the conceptual discussion in the Concepts Statement [No.7, "Using Cash Flow Information and Present Value in Accounting Measurement"] and the pricing methodologies and concepts presented in this book." This book is an excellent resource for financial professionals who need to perform any of the various methods discussed.—*Jean-Victor Côté*

Jean-Victor Côté, MBA, CMA, is an economist in Quebec, Canada. He can be reached for comment at jean-v.cote@sympatico.ca.