streetwise

BY STEPHEN BARLAS, JERRY LEVEY, LANCE THOMPSON, CURT VERSCHOOR, KATHY WILLIAMS

[NEWS]

FASB Issues Exposure Drafts to Support Global Accounting Standards | Kathy Williams, Editor

LAST MONTH THE FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) issued four new Exposure Drafts that would improve U.S. generally accepted accounting principles (GAAP) and converge U.S. accounting guidance with existing international accounting standards. Comments on each Exposure Draft are due by April 13, 2004.

The Exposure Drafts are:

- *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3* (Proposed Statement of Financial Accounting Standards). Voluntary changes in accounting policies would be required to be applied by retrospective application rather than by cumulative effect adjustment as is required now.
- *Exchanges of Productive Assets—an amendment of APB Opinion No. 29* (Proposed Statement of Financial Accounting Standards). This proposed Statement would require that exchanges of productive assets be accounted for based on the fair values of the assets involved unless the exchange transaction doesn't have commercial substance.
- *Earnings per Share—an amendment of FASB Statement No. 128* (Proposed Statement of Financial Accounting Standards). This proposed Statement would amend the computational guidance in SFAS No. 128 for calculating the number of incremental shares included in diluted shares when applying the Treasury stock method. It also would eliminate the provisions that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. And it would require that shares that will be issued upon conversion of a mandatorily convertible security be included in the weighted-average number of ordinary shares outstanding used in computing basic EPS from the date when conversion becomes mandatory.
- *Inventory Costs—an amendment of ARB No. 43, Chapter 4* (Proposed Statement of Financial Accounting Standards). Unusual ("abnormal") amounts of idle capacity and spoilage costs would be excluded from the cost of inventory and expensed as incurred.

The Board said that an additional proposed standard on the classification of liabilities is expected soon.

To download copies of the Exposure Drafts, visit the FASB website at www.fasb.org. For information on how and where to comment on the material, click on download, open each Exposure Draft, and read page 2. ■

IASB WELCOMES FASB RELEASES

The day the FASB released the new Exposure Drafts, the International Accounting Standards Board (IASB) said it welcomed their release. They are part of a joint effort of the two to eliminate differences between U.S. GAAP and International Financial Reporting Standards (IFRS). IASB and FASB hope to improve their respective accounting standards while reducing differences that confuse the investing public.

The two groups are also working on proposals to reduce differences in the accounting for research and development, income taxes, and interim reporting and are cooperating to reach similar conclusions on issues related to business combinations, share-based payment, and revenue recognition, the IASB said. ■

READERS INPUT

AN INCREDIBLE MAN

I recently saw the story on whistle-blower James Alderson in the August issue.

I am very familiar with Jim. When his story broke open concerning the fines, etc., he was living in Vancouver, Wash., which is across the river from where I am.

I am the founding president of the Oregon Association of Certified Fraud Examiners. One of the functions I helped start was an annual awards dinner for people who have made noteworthy contributions in fighting fraud in three major groupings—public, private sector, and government. We gave Jim the award for his work in the private sector group at the June dinner a couple of years ago.

He was very honored to receive it because he had pretty much been shunned by his professional peers. To again be recognized by a group like ours meant a lot to him. The winners give a brief acceptance speech, but the real value was in [talking] with him and his wife afterwards. About 12 of us sat around for a couple of hours, stuck to our chairs and almost in dead silence as we heard the ordeal he and his family had gone through and were still going through.

No one can imagine the pain they suffered. Sure, the outcome now looks good—but what risk

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[ETHICS]

Toward a Corporation with Conscience

Curtis C. Verschoor, CMA, Editor

ADAM SMITH IS BEST KNOWN FOR HIS MAJOR WORK, *THE WEALTH OF* *Nations*. Few realize that he also wrote a book on ethics titled *Theory of Moral Sentiments*. Smith concluded that market forces, or as he described it, the "invisible hand," would make the market most efficient if the forces of self-interest were restrained by conscience. He believed greed needed a strong restraint. Looking ahead from the 18th Century, Smith warned that corporations (which were called joint-stock companies then) could become amoral and cast aside the moderation of human conscience with disastrous results. Then and now, corporations have the power to potentially turn on the very societies that created them, causing environmental and social destruction.

Today corporations are granted many of the privileges of individuals. Yet, to many, they appear to be only bureaucratic entities whose most important objective seems to be self-survival and provision of outsize rewards for senior executives, especially the CEO. As a corollary, many believe that the major goal of bureaucracies, both corporate and public sector, may not necessarily be to get the job done most efficiently but, rather, to reward the level of personal loyalty of persons at the bottom to those in power at the top. The power to reward loyalty becomes the established currency of the organization and insurance for survival of those in power. This is practiced daily in the political arena.

As a result, there's considerable pressure on employees to obey directives coming from the top, regardless of any ethical doubts they might have. In fact, the selection process for new employees, as well as the promotion of existing employees, is based on their loyalty and obedience as well as their ability. The process downgrades any weight to individualistic qualities like conscience. A "team player" able to get along and go along with someone else's program is most prized.

The recent ethical scandals have demonstrated a need for change. The legislative solution, the Sarbanes-Oxley Act of 2002 (SOX), is extensive, requiring far-reaching changes in service industries like public accounting and corporate law as well as in the responsibilities of senior executives and board members. Congress reacted to a mandate to enact new laws that would "ensure" no similar malfeasance could ever reoccur. Provisions of SOX show that it's intended to require companies to expand their governance procedures. But this ignores the premise that the scandals weren't due to inadequate laws and regulations as much as they were a failure of ethical behavior.

Unethical behavior can take many forms in business. In fact, Jeffrey E. Garten, dean of the Yale School of Management and author of *The Politics of Fortune: A New Agenda for Business Leaders* (Harvard Business School Press, 2002), thinks it could even backfire. "In the wake of Enron," he said, "the possibility is that regulation is going to go much too far and that we are going to create a kind of audit society in which there is the illusion that if there are enough regulations and if you check off enough boxes, everything will be fine."

The trouble with such an over-regulated environment,

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[GOVERNMENT]

Corporate Tax Shelter Growth Decried

Stephen Barlas, Editor

A NEW REPORT FROM THE GENERAL Accounting Office (GAO) shows the pace at which illegal corporate tax shelters are growing and how much trouble the Internal Revenue Service (IRS) is having stanching the flow. Michael Brostek, director of tax issues for the GAO, testified before the Senate Finance Committee in October that the IRS has estimated that total tax losses due to shelters are $33 billion, some of that owing to individuals, of course. But those are only transactions the IRS knows about. An IRS contractor estimated annual revenue losses at between $11.6 billion to $15.1 billion a year, but it isn't clear how accurate even that broad-ranged estimate is because of methodological and data constraints that the contractor faced. The IRS says that for the 141 large corporations with cases still open in early May 2003, the amount of proposed shelter-related income adjustments was $47.6 billion, translating to about $16 billion in tax if not reduced.

The Committee hearings featured testimony from a former leasing industry executive, testifying anonymously out of fear of retaliation, about how tax shelter architects use the leasing of subway systems, bridges, and other public infrastructure items in the United States and Europe to shelter billions of dollars from U.S. taxes. Sen. Charles Grassley (R.-Iowa), chairman of the Committee, condemned "major corporations who can get a phony tax deduction." The Jumpstart Our Business Strength (JOBS) Act that Grassley's Committee passed on October 1 would close this loophole. Brostek explained that the IRS plans to increase the portion of its examination resources devoted to combating abusive shelters from 3% in 2002 to 20% in 2004. In doing so, it will have shifted resources out of examining the category of cases including such areas as net operating losses and claims for refunds. But Brostek noted the IRS has had trou-

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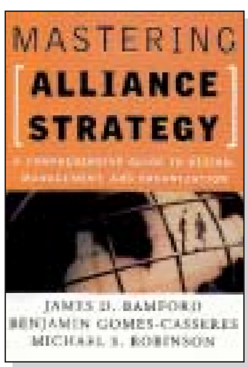
BOOKS

Mastering Alliance Strategy

✷ **BUSINESS ALLIANCES HAVE COME OF AGE.** Many companies have portfolios of 20 or more alliances, and some have more than 100. Many of the world's largest companies have more than 20%-50% of their assets tied up in alliances. But numerous studies have shown that between 30%-70% of alliances don't meet the goals of the parent companies and are failures, leaving executives asking how to make alliances successful. James D. Bamford, Benjamin Gomes-Casseres, and Michael S. Robinson, the authors of *Mastering Alliance Strategy*, believe that a comprehensive "alliance strategy" should be developed to define the intent, dynamic process, and logic that guides alliance decisions. A strategic alliance without an alliance strategy may be doomed for failure.



Alliances cover a range of forms, from stand-alone equity joint ventures to nonequity relationships, including enhanced supplier agreements, contractual research collaborations, marketing affiliations, licenses, and multipartner consortia. Most alliances share the following characteristics: agreements that involve ongoing resource contributions from each partner to create joint value; "incomplete contract" agreements because the terms can't be completely specified and agreed at the onset; and joint decision making to manage and share the value.

The four elements of an alliance strategy are:

1. Alliance design

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[ETHICS] *cont'd from p. 20*

Garten says, is that "when you're over-regulated, you begin to gear the system to comply with the regulations in such a way that you're adhering to the letter of the law but the actual spirit of it has totally evaporated."

Too often, when regulations become the guiding factor, two things happen. First, corporate leaders focus on meeting specifics in the regulations rather than trying to understand and live up to their purpose. Second, an inordinate amount of time is spent trying to navigate around the regulations without actually violating them. Nowhere is this clearer than when a new spate of tax laws is enacted. The result is a plethora of activity among tax professionals, especially in CPA firms it seems, to find loopholes so their clients don't have to pay.

If there is a lesson to be learned from the high-profile corporate scandals, it's that corporate behavior stems directly from the example set by the leaders at the top of organizations. The antidote to corporate malfeasance, then, is not new laws and regulations—it's putting in place corporate leaders who have shown they are capable of building a culture for doing the right thing, then holding them accountable.

Of course that appears to be more easily said than done. While it might be possible to screen prospective executives for past successes in managing corporate growth or achieving favorable stock performance, how do you measure them for something as subjective as integrity?

We know we can't legislate morality. But if we're looking for fixes in corporate America to restore the public's faith, we should ensure that the leaders we put in place are those we know are of the highest integrity, whether it's to lead a government agency or an American corporation.

The message to financial managers is that an effective, values-oriented ethics system is key to success.

"Power without conscience leads to corruption." ■

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[GOV'T] *cont'd from p. 21*

ble in the past meeting staff realignment goals.

Ways & Means Tax Bill

The American Jobs Creation Act passed by the House Ways & Means Committee at the end of October also has a tax shelter section. The House bill is pretty minimalist, addressing increased disclosure and penalties for tax shelters. It doesn't include any changes in the way the "economic substance" doctrine can be applied. The Senate tax bill goes pretty far beyond the House bill, however, and does clarify and enhance the application of the economic substance doctrine, something business groups oppose.

SEC Approves Board Independence Rules

Corporate board members will have to be much more independent, based on rules proposed by the New York Stock Exchange and the Nasdaq Stock Market and approved by the SEC in November. First, boards must have a majority of independent directors. In terms of a definition of "independent," the new rules go beyond the standard of "no material relationship with the company" to specify, for example, that a company employee serving as a director doesn't become independent until three years after his or her employment terminates. The definition also is extended to cover family members of a director who receive payments from the company or work at a second company where there may be overlapping board ties. The company would have to discuss these issues in its annual proxy statement or, if the company doesn't file an annual proxy statement, in the company's annual 10-K.

Senate Moving on Pension Discount Rate

A Senate committee passed a bipartisan bill that would stop corporations from having to overfund pension plans. The Pension Stability Act (S. 1550) passed by the Senate Committee on Health, Education, Labor, and Pensions replaces the 30-year Treasury Bond rate—the interest rate now used to determine pension liabilities. The new rate would be a blend of corporate bond rates, and will be in effect for a period of three years. It also creates a bipartisan Blue Ribbon Commission that would have to make recommendations on a permanent fix to Congress at the end of 2005 and be acted on within 120 days. The House passed the Pension Funding Equity Act (H.R. 3108), which establishes a new rate similar to the one in the Senate bill, only for two years instead of three, by a vote of 397-2 on October 8. ■

[LETTERS] *cont'd from p. 20*
and stamina to see it through. One has to realize that you have no friends when you do what he did. I immediately asked if he would be our dinner speaker for the joint OACFE and IMA October dinner meeting. He gracefully accepted.

I am a member of both groups, and I approached the local IMA chapter to hold a joint meeting with fraud as the predinner and dinner topic. We have now done this for the past three years, and it is a very well attended meeting.

But, in the interim, Jim and the family moved to Dallas. I was disappointed because I know he would have given a great presentation. I told him maybe we could work something out for expenses. His response was a bit startling. He said that even though he moved, he was still planning on speaking and would pay his own way back to do it!

He easily could have said he was sorry, but, being so far away, he was canceling. I should have known better that a guy who was so tenacious in his fight wouldn't take the easy way out.

Jim came back and gave a very gripping talk, taking us through the ordeal from its start to where he was then, which basically was fighting the government to be recognized as having brought value to the investigation. Believe it or not, the government types were trying to say he really hadn't done anything to aid them in their work. Just writing this part makes me furious because, without him, there would have been no case for them to grab the glory.

I haven't talked with Jim for a while, but was very pleased to see the story. He really should be asked to speak at the annual conference because he is an inspiration to all who hear him. While the headlines have gone to others, his work shook the Medicare program to its core and showed how corrupt the program is and how the players are gaming it for their own benefit.

Jerry Levey, CPA, CFE, CMA

[BOOKS] *cont'd from p. 21*
(role of alliance in business strategy, alliance goals and scope, partner selection, and structure for sharing value and decision making),

2. Alliance management (governance, relationship management, alliance roles and organization, and alliance evolution and exiting),

3. Alliance constellation (decisions, capabilities, and structures for the design and management of alliance portfolios), and

4. Alliance capability (internal organization, infrastructure, and knowledge management).

The authors caution us to think carefully about strategy before worrying about the details of the alliance. The business rationale for an alliance, the fit between partners, the incentives for cooperation, and the governance mechanisms all depend critically on the alliance strategy.

Alliances can create strategic value in six basics ways: build new businesses, access new markets, access skills and learning, gain scale, improve supplier effectiveness, and create advantaged networks.

Top firms have the best internal alliance infrastructure capabilities in the areas of staff, tools, systems, and organizational structure. Depending on the firm's strategy and nature of the alliance, as many as six alliance positions are key: dealmaker, launch manager, governor, alliance chief or joint venture CEO, alliance operating staff, and corporate alliance manager. These positions support the main tasks of alliance start-up, operations, and coordination. Alliance training is an important part of a collaborative core capability, and it should be linked to a wider corporate alliance infrastructure. Companies should have alliance training in an environment supported by other infrastructure processes, tools, and systems used to form and manage alliances.

Also discussed are alliance constellations, defined as a set of firms linked through alliances and competing in a specific business domain. Constellations are created to link markets, combine skills, build momentum, reduce costs, and share risks. The biggest challenge is the increased complexity. Careful attention to the group size, membership mix, internal rivalry, and governance help constellations succeed. Changes in the business environment, imitation and management fads, and competitive reactions to rivals are three factors that drive their growth.

Does alliance capability and strategy work best when done by a formal unit, with full-time staff, detailed processes, and a defined home in the organization? Or should it be more informal, with a looser structure and approach? Both approaches can be successful. In the end, most firms will choose a point somewhere between the two extremes, depending upon the corporate strategy, culture, and the role of highly centralized processes and controls. To determine whether a company should have a more formal or informal approach, look at the existing partners, company management, and the nature of the alliance portfolio.

The authors delve into a broad variety of case studies for companies successful with alliances: Coca-Cola (an entire business of marketing and bottling partners built as a constellation), Visa International (the credit card consortium defined as a shared utility established by multiple firms with the purpose of performing certain tasks that create the essential scope and scale), Colliers International (a real-estate and professional services constellation), Unisys (building successful models for alliance organization and capabilities), Lotus Development (bringing order to an alliance network that had evolved over time by creating a collaborative core capability of tools, processes, staff, and organization structure used to manage over 10,000 alliance members), FedEx (developed an alliance mapping tool to evaluate the potential value and requirements used to create a portfolio of alliances for distribution, electronic marketing, technology, logistics, and co-locating), Eli Lilly (with focus on culture and processes for successful alliances), and BellSouth and Dow Corning (top-down and bottom-up internal alliance training).

Mastering Alliance Strategy is a collection of best practices and best thinking. Approaches, frameworks, examples, models, and other tools are discussed to spark thinking and to develop a deeper understanding of how alliance strategy works, why some companies do what they do, and what you might consider doing in your company as applied to your own organizational and strategic context. This book is recommended for those interested in a comprehensive summary of alliances covering the entire life cycle.—*Lance A. Thompson*

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