streetwise

BY STEPHEN BARLAS, GLORIA BRAUNSCHWEIG, SARAH MILIUS, MIKE OSHEROFF, RICHARD VANGERMEERSCH, KATHY WILLIAMS

[NEWS]

Where Are We Headed? | Kathy Williams, Editor

WHAT'S GOING TO HAPPEN WITH THE ACCOUNTING PROFESSION HAS BEEN ON the minds of management accounting, financial management, and auditing professionals since the first of the seemingly endless number of corporate accounting scandals broke three years ago. Although the Sarbanes-Oxley Act of 2002 and the creation of the Public Company Accounting Oversight Board (PCAOB) started a series of sweeping reforms, most members of the profession say there's a great deal more work to be done in this area.

To this end, 57 leaders from accounting, finance, law, academia, investment banking, journalism, and nongovernmental organizations, and current and former regulatory officials from the Federal Reserve Board, the Securities & Exchange Commission (SEC), the General Accounting Office (GAO), the PCAOB, the Financial Accounting Standards Board (FASB), and the International Accounting Standards Board (IASB) met last November as part of the 103rd American Assembly to discuss the future of the accounting profession. During the meeting they considered three broad areas: the present state of the accounting profession, the desired future state, and how to reach that future state.

From the meeting came an insightful, thoughtful report titled *The Future of the Accounting Profession*, which you can access at www.americanassembly.org. The meeting participants said that, as a group, they were "generally satisfied with the new regulatory trends and the moves by corporate America toward reforming its own practices." They also said they felt the accounting industry "is moving to improve its own business after acknowledging that auditors have far too often yielded to management pressure to paint the most favorable picture possible of a corporation's financial health."

But they also noted that too much may be expected from the auditing process because it "requires more judgment and more subjectivity than has been recognized. It is unrealistic to now demand a greater degree of certainty." They added that, in demanding greater use of judgment, it should be the kind that comes from experienced auditors most likely to detect the early signs of fraud or malfeasance. And that's only going to come from the profession attracting more highly qualified people with diverse skills.

In summing up their discussions, the group suggested that corporate boards must take steps to guarantee the independence and integrity of the auditing process by appointing qualified audit committee members who will take full control of the audit process. And they recommended that the industry take a hard look at the way it deals with the recruiting, retaining, and compensation of

continued on page 20

FASB REAPPOINTS ED TROTT

IMA member Edward W. Trott, CPA, has been reappointed to the Financial Accounting Standards Board for a second five-year term beginning July 1, 2004.

Formerly a partner with KPMG, Trott began his career with the firm in 1968 in Greensboro, N.C., and also worked in the Tampa, Fla., office. He headed the Accounting Group in the firm's national office from 1992 through 1999.

He is a former member of the FASB's Emerging Issues Task Force and the AICPA's Accounting Standards Executive Committee. An IMA member since 1985, Trott served on IMA's Financial Reporting Committee.

He holds a bachelor's degree from the University of North Carolina and an MBA degree from the University of Texas. ■

THESE PROPOSALS MIGHT ALSO UNINTENTIONALLY REWARD THOSE LAWYERS WITH

READERS' INPUT

STRIKES A CHORD

Bob Gunn's "Capability vs. Capacity" [March 2004] really struck a chord with me. It provided great insights that complement much of what I have been working on recently in terms of professional development. He drew a clear picture for me of a way to connect with others—to be (forgive the buzzwords) authentic or genuine, to be in the moment with someone.

The article also helped me better understand how knowledge is only part of the mix. The example showed exactly that anyone may only need to be reminded to draw upon his or her own instincts or inner voice rather than have anything more imparted to him/her.

My career so far has lacked enough of this dimension in my working relationships, and that has held me back. I am

continued on page 20

Oops!

We goofed. The figures in the IMA Financial Summary on page 8 of the March issue don't foot. The correct figure for Total Liabilities and Net Assets should be $18,793, not $18,712.

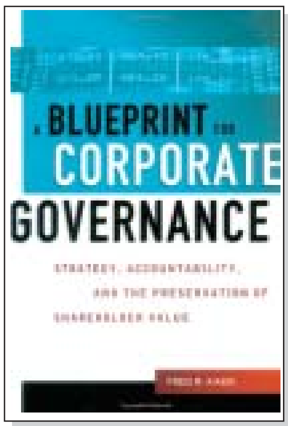
We apologize for the error.

BOOKS

A Look at Corporate Governance Worldwide

✷ **IN *A BLUEPRINT FOR CORPORATE GOVERNANCE*, FRED R. KAEN** explores how the modern corporation is managed for the benefit of its owners. While it is often thought that owners only indirectly exercise management responsibility, Kaen endeavors to show how a firm's owners, in concert with other stakeholders, ultimately do manage the firm and why the American system of maximizing shareholder value by way of the stock market points toward efficient management practices and serves the economy well.

Kaen explains how stock prices are based on three elements: a corporation's real earnings, its dividend policy, and its potential earnings. Firm managers, selected by a board of directors—who are in turn elected directly by stockholders—implement policies to maximize the firm's share price. Citing methods and models used to maximize and evaluate shareholder wealth, Kaen is clear: The American system of corporate governance is based on stock value. And the higher the stock value, the better the firm is being run.



In a perfect world, a higher price per share may indeed mean that a firm is being run well. Two points, which Kaen calls financial market inefficiencies, cloud the issue. The first is market transparency: Do the numbers really mean what they say? Looking at the three elements that influence stock price, it's difficult to say. Real earnings usually can be determined with accuracy—at least from an historical perspective—though, as Kaen has pointed out with the cases of Tyco, Lucent Technologies, WorldCom, and Enron, it's far too easy for management to hide information from boards of directors as well as stockholders, driving up earnings and artificially inflating stock prices. Dividend policy is usually constant from year to year or at least is a legal obligation of the firm when declared. Evaluation of future earnings is much more difficult, however, and may be based on conditions over which the firm has no control and of which the stockholder most often has only a vague idea. Price per share based on the former two elements may be constant, but price based on the latter would vary from day to day depending on what's happening to the rest of the economy. The result is fluctuation in stock market price.

The second financial market inefficiency is that investors have perfect knowledge of a firm's transactions, the evaluation of which can factor in the stock price. The American system of governance assumes that the boards of directors, elected by stockholders, have intimate knowledge of management financial dealings and will always act in the best in-

continued on page 21

[GOVERNMENT]

SEC Proposal on Lawyer Reporting Criticized

Stephen Barlas, Editor

NOW THAT THE SECURITIES & Exchange Commission (SEC) has finished its rulemakings on how internal and external auditors have to behave under Sarbanes-Oxley (SOX), it is turning its attention to lawyers. In-house attorneys are at the center of the "noisy withdrawal" rules that were the subject of a February hearing at the House Financial Services Committee. Both Democrats and Republicans on the Committee seemed to be unhappy with the direction the SEC appears to be heading.

The rules would apply to in-house corporate attorneys who find a material violation but who are ignored by corporate higher-ups. If the concerned attorney feared the material violation was about to result in "substantial injury to the financial interest of the company or investors," he or she would have to quit and report the violation to the SEC within one business day of cleaning out his/her desk. An alternative the SEC is also considering would require the company to report the departure of the attorney because of "professional considerations." Rep. Paul Kanjorski (D.-Pa.), top Democrat on the Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee, said, "Each one has the potential to alter the attorney-client privilege and could have a chilling effect on communications between management and counsel, making executives less likely to consult and speak frankly with lawyers. These proposals might also unintentionally reward those lawyers with lower ethical standards who would stretch the law beyond its reasonable interpretations and never withdraw from a client."

Senators Pursue Link Between Tax Shelters and Financial Statements

Just as the SEC is trying to clean up the rest of the remaining Sarbanes-Oxley rulemakings, some in Congress are beginning to think about SOX2. A next step, which has bipartisan support in the Senate, is a prohibition of public auditors rendering an audit opinion on the financial statement effects of any tax shelter arrangements that the auditing firm sells to an audit client. Sen. Charles Grassley (R.-Iowa), chairman of the Finance Committee, wanted to include this in the first SOX Act, but it got kicked out. Grassley hopes to take another swing at this issue now that the General Accounting Office is doing a report on the subject requested by Sen. Carl Levin (R.-Mich.), ranking minority member of the Permanent Subcommittee on Investigations, Committee on Governmental Affairs. There's still a lot of interest among key senators in stopping financial statement manipulation.

Pension Bill Moves Forward

The House and Senate are trying to reconcile their different pension reform bills

continued on next page

[GOV'T] cont'd from p. 19

now that the Senate has finally passed its bill replacing the 30-year Treasury bond rate as the indicator of the appropriate funding level for corporate defined benefit pension plans. The bill would replace the 30-year Treasury bond in pension calculations with a mix of long-term corporate bonds. The replacement would be temporary, however, lasting only through 2005.

Now at hand is the issue over which industries will be named in the final bill as being exempted from "deficit reduction contributions (DRC)." These are payments that companies in mostly hard-pressed economic sectors have to make to assure the viability of their pensions. The Senate bill exempts airlines and integrated steel companies. The House limits relief to the airline industry. Some in the Bush administration, including Treasury Secretary John Snow, say they will recommend a veto if the bill includes DRC relief. But so far the official word—from the White House Office of Management and Budget—is that it will "strongly oppose" DRC relief, wording that is several steps shy of an outright veto threat. ■

[NEWS] cont'd from p. 17

audit professionals.

Some of the other topics covered in the report include:

- What Went Wrong?
- Regulation and Oversight in Flux
- Value of the Audit
- Structural Challenges Facing the Accounting Profession
- Setting Achievable Goals
- What Should Financial Reporting Look Like in the Future?
- Improving Auditing and Financial Reporting Standards
- Licensing Issues
- Changing the Current Regime
- Preparing the Next Generation of Professionals

The American Assembly had been working on these issues long before Enron's problems and had planned their conference to address the challenges presented to the accounting profession by the ongoing technology-stock bubble and the evolution of the knowledge-based economy. The scandals just made their work more timely and more urgent. In concluding their message, they emphasized that "the accounting profession itself must recognize and expand its role, its responsibility, and its dedication to fulfill its mission to provide accurate and complete information to the investing public." ■

[LETTERS] cont'd from p. 18

much more aware now and am a very grateful reader for his revealing ideas. As a matter of fact, I just met with success after a 6+ month job search. I plan to continue my development and find more success.

Sarah Milius, CMA, CFM

YOU IGNORED STANDARD PRODUCTS

I've never written a letter to the editor before, but the January 2004 article "Grab Your Picks and Shovels! There's Gold in Your Data" made me take the time. The article completely ignores the mainstream, industry-standard business intelligence products: Hyperion, Cognos, Timeline, SRC Software....And then there are the mid-market products growing into business intelligence products: Microsoft's FRx, Lasata Software's F9 and Vision.

I'm disappointed that the article doesn't even mention these commonly known products, along with a multitude of Oracle and Microsoft SQL tools with OLAP cube functionality—all affordable, easy-to-use, mid-market and high-end business intelligence tools.

Gloria J. Braunschweig, CMA

I SECOND PAT ROMANO'S MOTION

This letter is to second the motion that Pat Romano made in his March letter. Pat suggested that "the direction of IMA should be reconsidered and modified" to go back to the success of its "Bold Step Publication Program."

Pat was too modest to note his own publication, *IMA's Legacy: Creating Value Through Research, A Window to the Future* (1995). This book listed and described each of the 231 NACA/NAA/IMA research publications from 1920 through 1994. This publication was also on CD-ROM. I urge all IMA members to review Pat's work and subsequent updates to note what great things the NACA/NAA/IMA has done in researching cost/management accounting.

On a more personal note, I have had the great privilege to work with Pat, Al King, Grant Meyers, Speed Koval, Julian Freedman, and Steve Landekich through the years. Along with C.J. McNair, I participated in the IMA Foundation for Applied Research project on *Total Capacity Management: Optimizing at the Operational, Tactical, and Strategic Levels* (1998). This project was started under the Bold Step program. I remember well the great excitement of that program in cost/managerial accounting circles. There was great competition for those research contracts, and, like Pat said, much good came from them.

Pat's 1995 study, with updates, needs to be stressed on the IMA website. Pat, in my view, hit the nail right on its head with his March letter.

Richard Vangermeersch, Ph.D., CMA, CPA

[STRATEGIC MGM'T] *cont'd from p. 8*

Strategy?") as it strategic planning platform. The strategic plan and balanced scorecard were developed by the board of directors and staff during a one-year period. Balanced scorecard strategy maps were being used at the board level and at the staff level. The linkages between the tenets of Mission Driven Strategy and performance measures were made clear using strategy maps. When strategy and execution reviews were mentioned as the next steps, this strategy-focused board enthusiastically embraced the idea. This is an example of a board and management committed to the tenet of making strategy and execution a continual process. This commitment was based on the strategic skills developed by using strategy maps along with the right strategy guidelines.

Choosing the Right Path

Every organization is looking for ways to improve its strategy and execution. Many have embarked on execution initiatives or have attempted to adapt strategic activities of "great" companies. Making strategy and its execution a continual and seamless process is one of the key principles to keeping your organization on the right path. Consider how strategy and execution reviews and strategy maps can help. ■

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[BOOKS] *cont'd from p. 18*

terests of the stockholders. Such knowledge usually is beyond the level of commitment of most board members, however, and the appointed management of the firm must make decisions between board meetings—without the direct consultation of the board of directors—that also affect shareholder value. The result is corporate governance by management, at least until the board can meet and affirm management activities.

Kaen also details two other models of corporate governance: the Japanese and German systems. In the Japanese system, central firms in a relationship called keiretsu own a majority of shares of other firms (e.g., Toyota, Mitsubishi, and Mitsui), which also include suppliers of parts and services needed by the central firms. The members of the keiretsu often share key executives who meet periodically during the year to share information with one another and to renew contracts of service. This widescale sharing of economic knowledge promotes stability in a changing business climate.

The German system of corporate governance is based on what Kaen calls a Universal Banking System. Stock ownership is highly concentrated, and a large portion of stock is owned by banks. Since banks make loans to corporations and also serve as fiduciaries for vendors and creditors, ultimate economic stability is guaranteed. Protection of one class of stakeholder interests in relation to the interests of any other is ameliorated because a loan loss would usually translate into an equity gain of the debtor firm, and total value would be maintained.

Kaen also talks about the Organization for Economic Cooperation and Development's 1999 pronouncement of corporate governance standards dealing with the rights of shareholders, the equitable treatment of all stakeholders of the corporation, issues of disclosure and transparency, and responsibility of the board of directors. Adoption of these standards by all countries should lead to equitable corporate governance and, ultimately, to optimum economic growth and prosperity through reliance on stockholder feedback by way of the market to management action and practices.—*Mike Osheroff*