streetwise

BY STEPHEN BARLAS, GARY NEILSON, LANCE THOMPSON, KATHY WILLIAMS

[NEWS]

What Constitutes a Successful Balanced Scorecard? | Kathy Williams, Editor

THE MOST EFFECTIVE SCORECARDS HAVE SIX CHARACTERISTICS IN COMMON, according to research by the Hackett Group, a business advisory firm and an Answerthink company that specializes in benchmarking and best practices:

Focus—The best scorecards are designed as day-to-day diagnostic tools to guide executive actions and aren't linked to compensation.

Balance—They include a mix of leading and lagging indicators that are keyed to internal and external financial and operating metrics. This mix should fit a company's specific needs and focus on its strategic issues.

Scope—They provide a limited number of balanced metrics at the top and then supporting metrics that help explain the meaning or cause of the top-level measures. And they are updated regularly when data changes.

Audience—They adapt to the audience. Many companies are now using scorecards for all employees, so they may have to include additional scorecards if the use extends beyond senior management. The same applies if the company has more than one business. Hackett says each scorecard should reflect the specific audience's responsibilities and concerns.

Technology—They match technology delivery to the need for timeliness in reporting and analysis.

Implementation—They are introduced in one division or level and then others when a comfort level has been reached in the first area.

Ironically, while effective balanced scorecards can really help companies see and understand how they are performing and where they can make changes, less than 20% of those that use scorecards have mature implementations that are creating value, the research found. The main reasons are that the scorecards include too many metrics and rely too much on historical financial information. Hackett says that companies report an average of 132 measures to senior management each month (83 financial and 49 operational), which is nearly nine times the number in effective scorecards.

These and more findings are included in Hackett's 2004 Finance Book of Numbers research. For additional information, visit www.thehackettgroup.com.

Donald M. Young Named to FASB

Donald M. Young, managing director of Young & Company, a provider of consulting and research services for technology and private equity

continued on page 22

JULIE ERHARDT NAMED AT SEC

Julie A. Erhardt has been named deputy chief accountant for the Securities & Exchange Commission, reporting to Chief Accountant Donald T. Nicolaisen. She will share day-to-day operations responsibilities with Scott Taub and Andrew Bailey that involve resolution of accounting and auditing issues, rule-making projects, and oversight of private sector standard-setting efforts and regulation of auditors.

The bulk of her career was spent at Arthur Andersen LLP, where she became a partner in 1998. She also served a two-year fellowship at the FASB and a seven-month interim assignment at the International Accounting Standards Board (IASB). ■

READERS' INPUT

ORGANIZATIONAL DNA

Regarding "Can Organizational DNA Exclude Ethics?" [Ethics, September 2004], we agree completely that values and ethics are critical to an organization's success.

As we examined the organizational DNA of successful companies, we found values and ethics a company displays are actually an outcome of its Organizational DNA—not an input to it. In our definition of Organizational DNA, it is the third factor, the motivators, that is particularly relevant. If unethical behavior is discouraged/punished through a rational and consistent system of motivators (e.g., pay, promotion decisions, terminations, avoidance by one's peers in the lunchroom, whatever someone cares about—not just money), then the company will come to display ethical behavior. If, on the other hand, the system "looks the other way" when people do unethical things, then you'll get unethical behavior. In terms of ethics or values, you'll get whatever the organizational environment will tolerate. But the Organization's DNA is what determines the organizational environment.

Booz Allen Hamilton also knows the "value of values" from personal experience—our own Core Values have guided us well

continued on page 22

[GOVERNMENT]

Corporate Accounting Problems Turn Up in PCAOB Review | Stephen Barlas, Editor

CORPORATE ACCOUNTING SHORTCOMINGS ARE COMING TO THE FORE AS A result of the publication of the Public Company Accounting Oversight Board's (PCAOB) sampling of Big Four audits that Chairman William McDonough alluded to last July in a House hearing. McDonough was vague about the problems at that time, but the report published at the end of August by the PCAOB was very explicit. The report contains PCAOB reviews of 100 Big Four audits performed between June and December 2003. Naturally, this is a small sample of the total audits the Big Four performed. Nonetheless, the results were disquieting enough to prompt statements of concern from the likes of Donald Nicolaisen, the chief accountant at the Securities & Exchange Commission. The biggest problem that popped up was the way corporations treat credit agreements, specifically the classification of certain debts as long term rather than as current liabilities. Twenty of the 100 companies whose audits were examined had to redo financial statements because of this credit reporting issue. The PCAOB review can be found at www.pcaobus.org/Inspections.

Tax Status of U.S. Subsidiaries Becomes "Outsourcing" Issue

A new Government Accountability Office (GAO) report makes U.S. international corporate tax policy an issue in the national debate over the dangers of "outsourcing." The new report points the finger at U.S. companies who win federal contracts because of the cost advantages they retain from having subsidiaries based in foreign "tax haven" countries. The report mentions a number of caveats to its finding. In general, however, the theme of the report is: "While some domestic corporations may also have a tax cost advantage, tax haven contractors may be better able to reduce U.S. taxable income to less than zero because of opportunities to shift income to their tax haven parents." Using tax liability as an indicator of ability to offset contract income, the GAO found that large tax haven contractors in both 2000 and 2001 were more likely to have a tax cost advantage than large domestic contractors. There is an amendment in the Senate bill called the JOBS Act—which was the large FSC/ETI replacement bill that was in a House-Senate conference as the 2004 session moved to a close—that eliminates the tax shelter at the center of the GAO report. The House version of the FSC/ETI bill didn't contain that amendment.

SEC's Donaldson Damns Anti-FASB Bill

SEC Chairman William Donaldson lent his weight to the pro-FASB forces in the Senate. In doing so, he strengthens the position of Sen. Richard Shelby (R.-Ala.), chairman of the Senate Banking Committee, who is refusing to bring up the Stock Option Accounting Reform Act of 2003 (S. 1890) for a vote. That's the bill that passed the House on July 20 by a vote of 312 to 111. Seen as an anti-FASB bill, the legislation stops way short of where the FASB

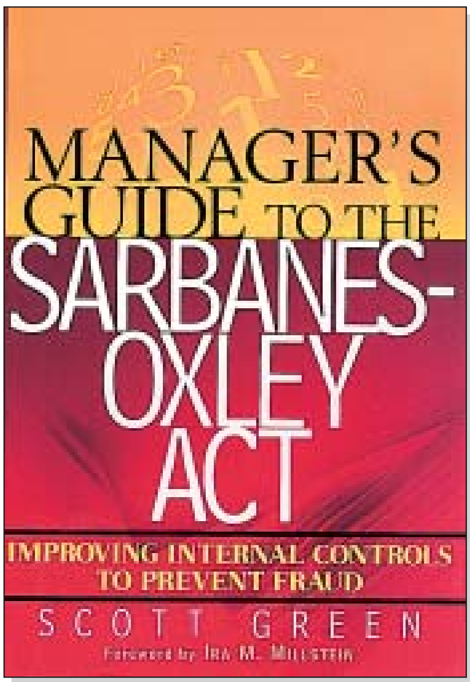
continued on page 22

BOOKS

Creating a Strong Control Environment for SOX

BY NOW, MOST FINANCIAL PROFESSIONALS, executives, and managers should know about the provisions of the Sarbanes-Oxley Act as well as the consequences of failing to comply with the Act. But many may still be struggling with how to ensure that their company does so. In *The Manager's Guide to the Sarbanes-Oxley Act*, Scott Green introduces the Control Smart approach that will not only help companies to meet the standards of Sarbanes-Oxley but also will help identify and prevent operational threats.

In order to mitigate risks, the Control Smart approach defines guidelines for a comprehensive evaluation of a company's system of financial, operational, and regulatory internal controls. The basic components of Control Smart—control environment, risk assessment, control activities, information and communications, and monitoring—also support and complement the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control—Integrated Framework*.



Control Smart enables managers to identify the types of risk affecting their business and focus on implementing process-level internal controls for those areas with control gaps. The recommended control structure helps monitor the health of the enterprise and alerts management when a boundary of expected behavior is compromised. The Control Smart approach to establishing a strong control environment includes five sections:

1. **See the threats coming.** The specific hazards of the business are evaluated by identifying the risks and assigning an owner for every risk.

2. **Know yourself.** All processes for which an individual has decision-making rights are identified and documented so that he/she understands the key activities and controls of the existing processes.

3. **Identify where you are vulnerable.** Gaps or threats are highlighted using the Smart Links assessment tool, which identifies key components of the business processes so that managers can focus on the operational risks by identifying the controls, boundaries of the control structure, and control gaps of the organization.

4. **Protect yourself.** The application of the Smart Links method to all processes results in the implementation of process controls and key performance reporting mechanisms. Green includes an index that contains examples of internal controls for many generic processes.

5. **Monitor your health.** This is the monitoring of the control environment through regular reporting of key performance indicators that measure the health of the business and provide the critical red flags for the company's control structure. There is an attestation checklist similar to what external auditors might use that helps executives evaluate their entity-level controls and governance processes.

A strong culture, either positive or negative, will directly impact the control environment. A strong positive control culture that reflects good values, ethics, rewards, and an effective monitoring program reduces the chance of a severe loss. The most effective control tool is a culture of open and uninhibited challenge of financial

continued on next page

[PERSPECTIVES] *cont'd from p. 6*

to everyone and provides a path for management accountants to expand beyond individual opportunities to strategic enterprise management, general operations management, external reporting, and compliance activities. It creates a scalable, standard process for spreading good "opportunity" management practices throughout the organization.

Successful management accountants know they tread a fine line between serving as critic and improvement facilitator as they put a financial reality on operational information. They work hard to go beyond good analysis and accurate reporting to engage the interest and earn the trust of the people who perform the value-creating work of the organization. By working proactively and positively, management accountants can help managers at all levels look beyond their present problems and manage their opportunities with less risk and greater success.

Have you had experiences in this area? Please contact me at lwhite@imanet.org. ■

[GOV'T] *cont'd from p. 20*

has said it intends to go on mandating stock option expensing. For example, S. 1890 requires expensing for only the top five executives of a company, but only after economic impact studies are done by the Departments of Commerce and Labor. Shelby wants to protect the FASB's independence from congressional micro-managing. So the anti-FASB forces must look for an unrelated bill that is about to pass the Senate to which they could attach S. 1890 as an amendment. Donaldson's letter in August to a number of senators, including Senate Majority Leader Bill Frist (R.-Tenn.), makes such an "end run" much less likely, given Donaldson's stature. Donaldson said that S. 1890 "would remove certain decision-making responsibility from the FASB and thereby disrupt the independent, private-sector accounting standard setting process." The American Electronics Association (AEA) is one of the chief proponents of S. 1890. It organized a "fly in" of members to the Senate on September 21. ■

[NEWS] *cont'd from p. 19*

clients, has been named a member of the Financial Accounting Standards Board effective January 1, 2005. He will complete the term of Gary S. Schieneman, who has resigned.

Young's career has been primarily as a technology analyst providing in-depth industry research and long-term investment advice on a broad range of technology companies. From 1998 to 2003, he was managing director with PaineWebber/UBS and was a managing director at Prudential Securities from 1996 to 1998. Young was a senior vice president at Lehman Brothers Inc. from 1990 to 1996 and a principal with Sanford C. Bernstein & Co., Inc., from 1985 to 1990. He also worked for Burroughs Corporation in a number of planning, marketing, and finance positions. ■

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

for 90 years, helping Booz Allen become one of the largest and most respected consulting firms worldwide. The strength and spirit of our firm are based in our values.

Gary Neilson
Senior Vice President
Booz Allen Hamilton

[BOOKS] *cont'd from p. 21*

policies, processes, and reporting. Some typical red flags for poor or improper financial presentation and disclosure practices are:

- ❖ Aggressive revenue recognition policies,
- ❖ Frequent nonrecurring charges or reversal of charges,
- ❖ Frequent changes in accounting policies,
- ❖ Related party transactions,
- ❖ Material topside entries affecting income, and
- ❖ Underfunded defined benefit plans.

Backed by real-life examples, *The Manager's Guide to the Sarbanes-Oxley Act* provides valuable insights and guidance for business professionals who want to design and implement controls, create monitoring tools to help identify poor performance, take self-correcting action, and to otherwise meet SOX's requirements. The goal is to provide tools to develop a strong, well-controlled environment that will help prevent fraud, embezzlement, and unintentional financial loss for any company. This book is a must read for all business stakeholders (not just auditors and accountants) who need to add control assessment and compliance skills to their business tools, and it is a great starting point for understanding SOX and its ramifications.—Lance A. Thompson

Lance A. Thompson, Thompson Management Consulting Services, LLC can be reached at lancephx@aol.com.