# streetwise

BY STEPHEN BARLAS, JIM KNEPP, MALCOLM SCHWARTZ, LANCE THOMPSON, KATHY WILLIAMS

**[NEWS]**

## Three IMA Members Named to COSO Task Force | KATHY WILLIAMS, EDITOR

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) has begun a new project to provide guidance to small businesses on how to apply the *COSO Internal Control—Integrated Framework*. The Control Framework has been widely accepted as the internal control standard for organizations in complying with Section 404 of the Sarbanes-Oxley Act of 2002 (SOX) and the Public Company Accounting Oversight Board (PCAOB) Standard 2.

As part of this initiative, COSO has named a Small Business Control Guidance Advisory Group Task Force to oversee the project. The three IMA members appointed to serve on the Task Force are:

- **Kristine M. Brands**, CMA, CPA, senior analyst at Oracle Corporation in Colorado Springs, Colo.;
- **Rudolph J. McCue**, CMA, CFM, CPA, president of WHPH, Inc., in Winchester, Ky.; and
- **James K. Smith III**, CMA, VP & CFO of Phonon Corp. in Simsbury, Conn.

Their group will provide guidance to small businesses regarding SOX Section 404 compliance. The chair of their group, Deborah D. Lambert, co-founder of Johnson Lambert & Co. in Raleigh, N.C., was appointed to the Securities & Exchange Commission's Advisory Committee on Smaller Public Companies. After establishing this Committee, the SEC asked COSO to begin the project to help small companies.

The Task Force held its organizational meeting in January and is now beginning its work. They would like to invite any IMA members to share their thoughts about SOX Section 404 compliance, so please e-mail your comments to Kristine Brands at brandsima@pcisys.net.

### FASB Seeks Codification and Retrieval Project Participants

In September 2004, the Financial Accounting Foundation (FAF) trustees approved the Financial Accounting Standards Board's Codification and Retrieval project that will substantially change the way constituents access financial reporting standards. Instead of users searching files of multiple standard-setting bodies and other authoritative sources, they will be able to go to one source that houses all U.S. GAAP literature, segregated for private and public companies.

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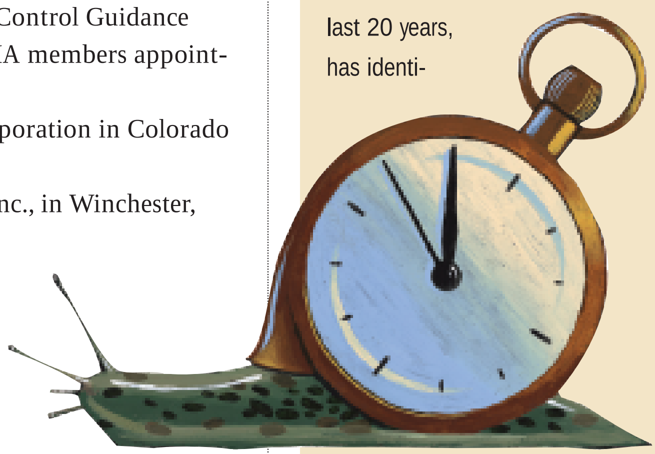
### TIME WASTERS

Donald E. Wetmore, a professional speaker from the Productivity Institute who has been conducting time management seminars over the last 20 years, has identified five major time wasters for people to attack. They are:



**Poor Planning.** Without a plan of action for the day, people tend to direct their attention to the most urgent thing that comes up, and this isn't necessarily the best use of their time, he says. Then the day will be filled with "wheel spinning and busy-ness rather than business."

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## Letters to the Editor

### Ethics on the Mark…

Curt Verschoor's article on SOX 404 on pages 17-18 in the March 2005 issue of *Strategic Finance* is right on the mark and consistent with what I have been saying since the law was passed. Unfortunately, SOX was passed in the turmoil (panic?) of the Enron aftermath without any focus on the true root causes of the fraud. As time has passed it has become increasingly clear that the basic controls over day-to-day processing of transactions didn't fail at Enron, HealthSouth, Adelphia, Tyco, etc. In all cases, the key issue was senior management overriding the controls. As Curt points out in the article, most of the work and cost associated with implementing 404 won't correct or uncover this breakdown in corporate controls. Hopefully, the sessions held with the SEC in April will help bring some rationale into the process, which will hopefully lead to the PCAOB following suit by revising Audit Standard #2.

**Jim Knepp**

### …And on Target

As one of the principal authors of *Internal Control—Integrated Framework*, a member of the current COSO task force dealing with simplified guidelines for Sarbanes-Oxley compliance for smaller companies, and a practitioner in this area of management consulting since before the COSO Framework was published in 1992, I am writing to say that

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**[GOVERNMENT]**

## SEC Roundtable on Section 404 | STEPHEN BARLAS, EDITOR

The fact that the Securities & Exchange Commission (SEC) scheduled a roundtable on Section 404 of Sarbanes-Oxley for April without initially setting a definite date for that confab reflects the pressure the SEC is under from the business community. Groups such as the U.S. Chamber of Commerce have been actively whispering in the ears of Bush administration officials that the internal controls requirements of Section 404 are too costly. SEC Chairman William H. Donaldson has been under pressure to respond. That explains the February 8, 2005, publication of the notice proclaiming that the roundtable is "tentatively scheduled for April 2005." Asked why no date had been specified, John Heine, an SEC spokesperson, said, without further clarification, "What you see is what you get."

Section 404 and the rules adopted by the SEC require all U.S. and non-U.S. entities that file annual reports to report on management's responsibilities to establish and maintain adequate internal controls over the company's financial reporting process. Each report must include management's assessment of the effectiveness of those internal controls.

Whenever the roundtable takes place, it will be the start of an analysis period that will last through spring, according to Donald T. Nicolaisen, the SEC's chief accountant. "The SEC and Public Company Accounting Oversight Board are committed to working closely together to determine ways to improve the crucial internal controls process without sacrificing investor protection," he says.

It's highly unlikely that the SEC will change its 404 rules in a major way. Cynthia A. Glassman, an SEC commissioner, says, "It may be too early to truly be able to assess the costs and benefits of Sarbanes-Oxley, especially when one of the final provisions has not been fully implemented, and the main intended benefit, restoring investor trust, will take time to be fully realized."

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### Treasury Gussies Up 401(k) Rules

With the Pension Benefit Guaranty Corporation (PBGC) possibly heading for stormy seas (as reported last month), it's no surprise that the Treasury Department is trying to make 401(k)s easier to fund and manage. That's the backdrop to the Department's final rule

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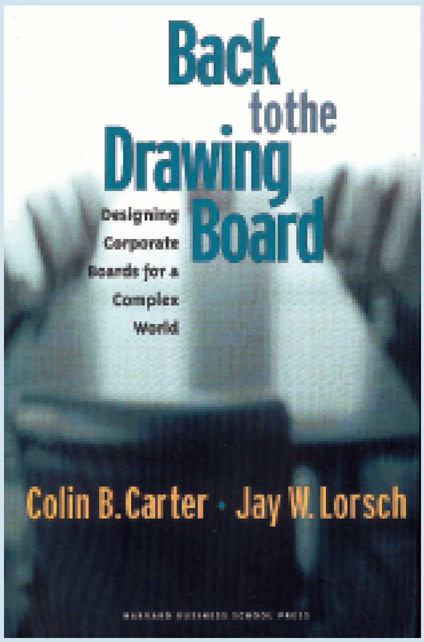
[BOOKS]

# Reexaming the Board of Directors

The design of boards of directors is clearly flawed in too many places, and board practices are still held captive to the traditions of years past. Directors often have inadequate time and a limited knowledge base to sufficiently meet their long list of responsibilities. With the increased focus and worldwide interest in better corporate governance to support initiatives such as the Sarbanes-Oxley Act, many boards of directors will need to rethink their roles and practices. In *Back to the Drawing Board: Designing Corporate Boards for a Complex World*, authors Colin Carter and Jay Lorsch address this fundamental reexamination that many boards will undertake and discuss areas to make improvements.




Carter and Lorsch present eight best practices that focus on empowerment, independence, and alignment. They also discuss certain contradictions to these best practices that can't be resolved and require making key choices to find the right balance. Some of the contradictions are:

1. Director independence is widely demanded but can come at a cost that often goes unrecognized.
2. Financial alignment of directors is a good thing, but it can erode the board's independence.
3. The board's monitoring role can undermine its ability to carry out its other duties.
4. Directors are expected to be generalists, but that likely leads to a superficial engagement with the business.
5. Boards are told to maximize shareholder value, but a wider stakeholder view is what drives success and value in many businesses.

The authors suggest that boards need to return to the basic questions, starting with their roles. Each board should consider these elements in its design:

- Board structure—its size, leadership, and the committees required;
- Board composition—the mix of experience, skills, and other attributes of its members; and
- Board processes—how it gathers information, builds knowledge, and makes decisions;

The choice that a board has with its role is figuring out how engaged it needs and wants to be. There are two types of roles, each of which imply very different intentions and levels of engagement. A board that makes and approves many decisions has a "pilot" role. On the other hand, a board that limits itself to monitoring company performance, offers little advice, and is involved in few decisions is in a "watchdog" role. Whatever the role, however, all boards should have an audit committee, a compensation committee, and a corporate governance committee made up of independent directors.

The directors themselves must decide on the structure that will best allow them to do the job at hand. The authors' experiences are that smaller boards are more effective than larger ones. Boards should consist predominantly of independent directors, though there is no "right" ratio of insiders to outsiders. Every board needs to provide clear leadership for the independent directors by either separating the jobs of chairman and CEO or establishing a "lead director."

According to research by Carter and Lorsch, there is no clear relationship between shareholder returns and governance structures. What really counts for board performance and good corporate health are the dedication, energy, time commitment, and skills of the directors, the quality of their information, the leadership of board discussions, and the level of openness, transparency, and

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

issued in late December on company administration of employee stock ownership plans (ESOPs), whose rules were last changed over a decade ago. Congress ordered Treasury to modernize the rules for ESOPs when it passed the Small Business Job Protection Act (SBJPA) of 1996. It has taken Treasury eight years to implement those reforms. The most substantial changes had to do with nondiscrimination tests that are based on either of two calculations: actual deferral percentage (ADP) or actual contribution percentage (ACP), depending on the kind of company stock plan involved. Those tests help a company determine whether enough lower-paid employees are in a particular plan, which is a threshold determination for allowing higher-salaried employees to both participate in a plan and, in some cases, exceed what they might otherwise contribute. Under the reforms, employers who find they have allowed higher-paid workers to contribute too much will have more flexibility in undoing their error. The new rules go into effect in 2006 for most companies.

## Tax Panel Starts Deliberations

It is way too early to say whether the President's Advisory Panel on Federal Tax Reform will lead to legislation making significant changes in the tax code, but one thing is certain: The panel won't be restricting its review to individual taxes. Business taxes are up for grabs, too. Former Sen. John Breaux, the panel's co-chair (former Sen. Connie Mack is the chair), said at the panel's first meeting in mid-February, "Reform is not just about the possibility of eliminating mountains of paperwork—it's also about global competition. Now is the time to take a critical look at whether our tax code is an obstacle to U.S. businesses—both here at home and abroad."

## IRS Budget

Speaking of a fairer tax system, President Bush thinks another way to get that done—besides a wholesale revision of the code—is to make sure everyone is paying what they owe under the current system. That's why he proposed boosting the IRS's enforcement budget from the $6.392 billion Congress approved for FY 2005 to $6.893 billion for fiscal 2006, which starts October 1, 2005.

One of the IRS's major enforcement efforts has been in the area of tax shelters. On February 15, the IRS designated "sale-in/lease-out" (SILO) arrangements as abusive tax avoidance transactions. SILO arrangements are designed to exploit the tax law by shifting tax benefits from a tax-indifferent party that can't use them to a taxpayer that can. Taxpayers entering into SILO arrangements can't claim tax benefits as the purported owners of property subject to the lease because they don't acquire tax ownership of the property. In the American Jobs Creation Act of 2004, Congress enacted limitations on the deductibility of losses from future SILO transactions. The IRS says that it will challenge the purported tax benefits claimed by taxpayers entering into earlier SILO transactions. It further states that it will consider SILOs to be "listed transactions," requiring taxpayers who enter into SILOs to disclose their participation to the IRS. ■

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

trust in the relationships among directors with top managers.

Future boards of directors will be asked to face more challenges with inadequate resources to meet them. Carter and Lorsch identify best practices and discuss the inherent contradictions that most boards struggle with when trying to gain an overall balance between their time and knowledge constraints. They have written a timely and provocative book that looks inside the rather closed and exclusive nature of most boards. Real-world business realities are presented and combined with the latest academic theory, and also included is a survey of CEOs from publicly listed companies that shows how they view nonexecutive directors and the effectiveness of their boards.—*Lance Thompson*

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

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

Curt Verschoor's comments [March 2005], in my opinion, are very much on target. I hope that our task force will address some of these concerns, many of which I have spoken and written about. I believe that SOX is fine but its application through the PCAOB and audit firms has become badly skewed and is focused on things that public accountants know how to do and are marginally relevant to SOX.

I always enjoy reading someone who agrees with me, almost more than reading someone who does not.

**Malcolm Schwartz**
*SVP, Compliance Practice Leader*
*Technology Solutions Company*
*Chicago, Ill.*

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

Reenergizing management accounting, rebalancing the accounting profession, promoting the professionalism of CMAs and CFMs, differentiating management accounting expertise, exploring new horizons in management accounting, and seizing a leadership role for management accounting globally—these are the topics I've written about this year, and you can feel confident these themes are shared by, and in many cases inspired by, our new President and CEO Paul Sharman.

Thoughts? Please e-mail me at lwhite@imanet.org. ■

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

This will also give them immediate access to any new guidance or pronouncements that are issued.

Throughout the development phase of the project, the FASB will solicit user feedback on the features of the codification and the retrieval application. Financial professionals can participate in brief, 15-minute Web surveys four times a year or in focus group sessions at a physical meeting location or via a Web conference. The Board expects the focus groups to last two hours or less.

To sign up as a survey and/or focus group participant, go to www.fasb.org and click on the Codification and Retrieval Project, then click on the link under User Feedback. ■

**[TIME WASTERS]** *cont'd from p. 19*

**Procrastination.** Taking the time for planning is great, he notes, but what if people don't execute their plans? "You tend to put off doing what you know you ought to be doing when there is little or no pain for not doing it and little or no pleasure to do it," he notes. Don't procrastinate the important items, or they just tend to pile up and become harder to work on.

**Interruptions.** These really rob people of their productivity, he emphasizes, and they can come from people dropping by in person or electronically. He explains: "Interruptions are both good and bad. There are A (crucial) and B (important) interruptions that you receive without reservation," and they have value. It's the C (little value) and D (no value) ones that are the major problems.

**Failure to Delegate.** No one has the time to do everything these days, so people need to learn to delegate. It gives others the chance for accomplishment, and the one who delegates can leverage their time through other people and get the benefit of additional expertise and time.

**Attending Meetings.** There are 17 million meetings in a typical day in the U.S., Wetmore notes. And they are major time wasters for many people, particularly when there is no agenda or time frame, which means participants can go from one tangent to another with no concrete results. Managing meetings is a positive way to save time and energy and be more productive. ■