streetwise

BY STEPHEN BARLAS, LANCE THOMPSON, KATHY WILLIAMS

[NEWS]

Accounting Leaders Want Stronger Enterprise Governance, Government Accountability | KATHY WILLIAMS

In a discussion last month to determine the strategic priorities for the accounting profession over the next five to 10 years, chief executives of several worldwide accounting organizations called for improvements in the quality of governmental financial reporting and financial management, stronger enterprise governance, and better marketing of the value of the profession. The International Federation of Accountants (IFAC) held the meeting in which the leaders of 35 of its member organizations and regional accountancy organizations participated.

IFAC said that the group agreed that the international profession must take a strong role in advocating that governments should follow standards in line with those to which they expect companies to adhere and, in particular, must promote the use of IFAC's International Public Sector Accounting Standards as a means to strengthen governmental financial accountability. The meeting participants also said that greater numbers of professional accountants should be serving on boards of directors and in CFO positions and that this could contribute to enhanced corporate performance and economic growth and development.

> Greater numbers of professional accountants should serve in CFO positions.

Regarding the recruitment, training, and retention of accounting professionals, "Shortages in the availability of qualified professional accountants and shortages in the quality of potential recruits can seriously affect the production of quality financial information—information which is critical to investors. It can also affect business development, jeopardizing economic growth," IFAC President Graham Ward explained. "Better communicating the value of accountancy qualifications and career opportunities and reducing the personal financial risks faced by accountants in practice and in business through liability reform are among the ways in which we can make the

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SEC, PCAOB WANT SOX FEEDBACK

The Securities & Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) are holding a roundtable on May 10, 2006, at the SEC's headquarters in Washington, D.C., to discuss companies' experiences during their second year of complying with the reporting and auditing requirements of the Sarbanes-Oxley Act (SOX) related to internal control over financial reporting. Issuers, auditors, investors, and other interested parties will participate.

To add to the discussion, the SEC and PCAOB want written feedback from registrants, auditors, investors, and others about their experiences complying with SOX Section 404. Anyone who would like to submit their comments should do so before May 1, 2006. You can submit via the Internet at www.sec.gov/news/press.shtml or send an e-mail to rule-comments@sec.gov. Please include File Number 4-511 on the subject line.

For more information, visit www.sec.gov/news/press/2006-22.htm. ■

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profession more attractive and address recruitment and retention issues."

IFAC Seeks Public Members for Ethics, Public Sector Accounting Standards Boards

IFAC is seeking nominations for a public member for the International Ethics Standards Board for Accountants and for the International Public Sector Accounting Standards Board, which are independent standards-setting boards within the organization.

The Ethics Board develops high-quality ethical standards and other pronouncements for professional accountants around the world. The IPSASB develops high-quality accounting standards for use by governments and other public sector entities around the world in the preparation of general purpose financial statements.

Nominees for either position must have an appropriate level of knowledge about the work of the respective board, but they don't have to have a professional accountancy designation. For more information, including time commitments, see the Call for Nominations on IFAC's website at www.ifac.org/NominatingCommittee. Individuals and organizations who are interested in submitting candidates can use the Candidate Information Form at www.ifac.org/NominationForms. Nominations must be submitted by April 15, 2006. ■

[GOVERNMENT]

SEC Proposes Changes to Executive Pay Reporting | STEPHEN BARLAS, EDITOR

SEC Chairman Chris Cox continued on what has to be called an ambitious reform agenda—much more ambitious than predecessor William Donaldson's—with his January 17 proposal, backed by all four commissioners, to require better disclosure of the pay packages awarded to a company's top five executives. Those disclosures would be made in a new Compensation Discussion and Analysis section that would replace the Compensation Committee Report and performance graph. The rule changes would also amend Form 8-K to focus current disclosure of executive compensation arrangements on unquestionably or presumptively material events. In the new compensation section, companies would have to furnish tables in annual filings showing the total yearly compensation for their chair, chief financial officers, and the next three highest-paid executives. Also under the SEC proposal: (1) The level at which an executive's total perks must be detailed would be reduced from $50,000 to $10,000, (2) new disclosure tables for executives' retirement benefits and the compensation of company directors would be required, and (3) annual filings would have to include sections on executive pay written in plain English. SEC Commissioner Roel Campos explains the initiative, quipping, "Payment for performance has been replaced by payment for pulse."

Early reaction from the corporate community was essentially positive. Business Roundtable President John J. Castellani said the SEC proposal seems to track with the Roundtable's "Principles of Executive Compensation" issued in 2003. But Castellani's group wants to take a closer look at the SEC proposal to make sure that "any rules regarding disclosure of executive compensation have an appropriate way of calculating the value of stock options in order to avoid overstating compensation." He adds, "In addition, we want to make sure that the disclosure rules do not reveal to competitors strategic information about compensation tied to a company's business goals or product development plans."

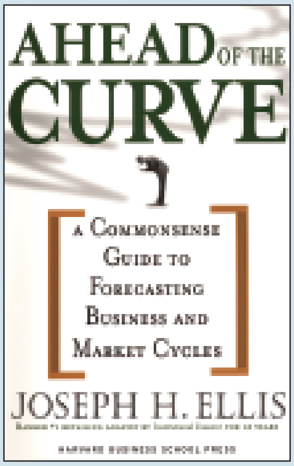
New SEC Policy on Civil Penalties for Accounting Misdeeds

The very specific dollar-level aspects of SEC Chairman Cox's executive compensation reform proposal made it stand out starkly from a second reform initiative the SEC announced earlier in January: a new policy on civil penalties. There the Commission was trying to signal to the business community when a company and its executives could expect a penalty at the level of the ones assessed WorldCom, Inc. ($750 million) and Adelphia Communications Corp. ($715 million) or one more along the lines of the $50 million fine Cox announced that same day on McAfee, Inc. Or maybe no penalty at all. But *continued on page 61*

[BOOKS]

Predicting Business Cycles

The resulting sense of uncertainty in dealing with the economic and investment outlook is a universal problem for business managers, investment professionals, and individual investors. In *Ahead of the Curve*, published by Harvard Business School Press, author Joseph Ellis presents a methodology for simplifying and clarifying the use of economic data in forecasting the basic direction of the economy and the likely direction of the stock market. By effectively charting the rate of change in the most predictive leading indicators, the key inflection points (upturns and downturns in trend) can usually be identified ahead of the prevailing economic forecasts.



Ellis identifies the key drivers of economic cycles and the sequence of indicators as they develop in economic advances and declines. The clear, sequential cause-and-effect chain (analyzed by charts of economic data of the last 40 years) from consumer spending to industrial production to capital spending to corporate profits provides a strong analytical base for businesses and investors. Turning points in consumer spending (the largest component of U.S. GDP) can predict inflection points in the economy at large and often the stock market.

If consumer spending is dominant in the economy to such an extent that it is the indicator able to predict the direction of the overall economy, how can it be forecasted? Ellis asserts that the wage growth of the employed (real average hourly earnings) is the most effective single leading indicator of consumer spending except when there are major tax changes. Slowdowns in real hourly wage comparisons are often a clear signal to reduce exposure to the stock market. Uptrends have proven to be less consistently useful in signaling new bull markets.

Most stock market declines commence when the year-over-year rates of growth in the economy, starting with real consumer spending, begin to slow from peak rates. Because the market typically advances in anticipation of the upturn, the bear market, in most cases, comes to an end approximately six months before the trough in year-over-year consumer spending. This creates many intuitive challenges for the investor because bear markets typically start when the growth in consumer spending is at or close to its peak with a very healthy economy. Investors who want to buy in at market bottoms do so as the economic comparisons are still deteriorating sharply.

Ellis discusses several key flaws in the way economic data is typically reported and analyzed. Recession is such a lagging indicator of a slowing economy that it is largely useless to business managers and investors. When recession, as the wrong definition of economic harm, and quarter-to-quarter (instead of year-over-year) rates of change are combined, the result is confusion about the real inflection points in the business cycle. Other lagging economic indicators, such as employment and capital (business) spending, are often mistakenly viewed as primary economic drivers that deceive the unwary into remaining positive well past the peak in the economy or remaining pessimistic well beyond the trough.

Ellis also includes chapters describing the key link between inflation and interest rates and consumer spending, the effect of interest rates on the stock market, and the link between federal deficits and interest rates. "Section IV: From Theory to Practice" provides advice on how to apply the charting disciplines to specific industry, company and individual forecasting needs. He provides a website (www.aheadofthecurve-thebook.com) where the economic data series for the most important charts are maintained, providing an updated perspective on the current economic and stock market outlook.

Ahead of the Curve is essential reading for business executives, analysts, and investors in every industry who need to forecast economic cycles in order to position themselves for economic and

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there are no dollar ranges in the policy statement, and a strict reading of the new policy seems to raise as many questions as it answers.

The guidance simply says, in effect, that getting a direct and material benefit from an accounting rule violation is justification for the SEC coming down harder on the company than for any other kind of violation, for example, if the company is unjustly enriched. There's no definition, much less dollar figures, attached to those terms. Some of the wording is confusing, too. The SEC guidance indicates that a whopping penalty might be justified if it can be distributed to innocent shareholders. On the other hand, it worries that a large penalty might hurt the company and its innocent shareholders. Which is it?

New E-Filing Requirement at Issue

The Tax Executives Institute (TEI) is pressing Congress to countermand an IRS requirement that large companies file their 2005 tax returns electronically. For tax year 2005 returns that are due in 2006, the regulations require that corporations with total assets of $50 million or more file their Forms 1120 and 1120S electronically. The electronic filing requirement applies to entities that file at least 250 returns, including income tax, excise tax, information, and employment tax returns during a calendar year. The TEI has been arguing for the past year that the regulations defining the specifics lack important details and that major corporate software vendors are unprepared with products. "This means that taxpayers using different programs are 'on their own' in satisfying the mandate," says Timothy J. McCormally, TEI's executive director. Similarly, the waiver criteria the IRS promised to publish by September 1, 2005, but didn't come out with until November 10 aren't crystal clear either. "For example, the IRS has indicated on several occasions that companies undergoing mergers and acquisitions may be candidates for relief, but nothing in the notice addresses this issue," McCormally complains. As a result of these minefields, the TEI wants Congress to step in and tell the IRS that only the first four pages of the 2005 Form 1120 need to be filed electronically in 2006; the remainder of the forms and schedules would be phased in over the next few filing seasons. ■

[BOOKS] *cont'd from p. 25*

stock market uptrends and slowdowns. It's also useful for anyone who wants to better understand economic principles and their predictive interactions. Due to the author's reliance on 40-year charts to support his conclusions, the book requires some discipline and time to understand these charts and the cause-and-effect and sequential relationships for forecasting purposes. Ellis uses nontechnical terms to explain the critical factors that can help businesses and individuals better predict the economy and stock market, increasing their competitive advantage and profits.

Ellis has more than 35 years of experience as a Wall Street veteran and partner with Goldman Sachs, where he headed the Retail Research Group. *Institutional Investor* magazine ranked him as the top retail investment analyst on Wall Street for 18 consecutive years. ■

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