streetwise

BY STEPHEN BARLAS, MIKE OSHEROFF, LANCE A. THOMPSON, KATHY WILLIAMS

[NEWS]

Leslie Seidman Reappointed to FASB | KATHY WILLIAMS

IMA member Leslie F. Seidman, CPA, has been reappointed to a five-year term as a member of the Financial Accounting Standards Board (FASB). Her new term starts on July 1, 2006, and runs through June 30, 2011.

Before joining the Board in 2003, she managed a financial reporting consulting firm that served global corporations and other concerns. In the late 1990s, she was an industry fellow, a project manager, and assistant director of research for the FASB. She also held executive positions at J.P. Morgan & Company from 1987 to 1996, including vice president of accounting policy. Seidman started her career in accounting at the former public accounting firm of Arthur Young & Company in New York City after graduating from Colgate University with a B.A. degree in English. She later earned an M.S. degree in accounting from New York University.

FASB, IASB Reaffirm Commitment to High-Quality Common Accounting Standards

The FASB and the International Accounting Standards Board (IASB) published a memorandum of understanding in late February that reaffirms their shared commitment to developing a common set of high-quality accounting standards to use in the world's capital markets.

Both Boards said that such standards would "enhance the consistency, comparability, and efficiency of financial statements, enabling global markets to move with less friction."

The groups noted that the MOU is a further elaboration of the objectives and principles described in their Norwalk Agreement, which was published in October 2002. Titled "A Roadmap for Convergence between IFRSs and U.S. GAAP—2006-2008," the MOU describes the goals and objectives of the work the two groups are doing together and gives possible dates for completing some of the projects. For example, by 2008, they want to be able to reach a conclusion about whether major differences in a few focused areas should be eliminated through one or more short-term standards-setting projects and to complete the work if

continued on page 61

PCAOB FORUMS

The **Public Company Accounting Oversight Board (PCAOB)** is holding several forums on auditing in the small business environment for auditors from smaller registered public accounting firms and directors and financial executives of smaller public companies. Participants will learn more about the work of the Board, specifically the PCAOB inspections process and the impact of the new auditing standards.

The current schedule is

San Antonio, Texas . . . May 2-3, 2006
Seattle, Wash. . . . . June 21
Boston, Mass. . . . . September 8
Philadelphia, Pa. . . . . October 16
New York City. . . . . November 7-8
Chicago, Ill. . . . . December 7

For more information, contact Julie Mills at (202) 207-9061.

Letters to the Editor

Thank You

Dear IMA—This is just a quick note to say "thank you." My membership has already proved to be meaningful to me—and not in a way that I had initially intended.

Just prior to completing my MBA, I was selected as a finance intern at a small local private equity backed company. This was a highly visible assignment, I reported to the VP of Finance and Administration…My assignment was to evaluate liquidity options for the firm: possible sale of the firm, additional investment capital, etc. My final report was intended to go in front of the board of directors.

After publication of my draft final report to the CEO, with the advice and consent of the VP of Finance and Administration, I was appalled to read an e-mail to me from the CEO asking me to delete or revise many of my findings. This was disturbing to me as I assumed the board needed access to all relevant information to aid them in their decision-making process. I was unsure what to do.

I went to the IMA's website and reviewed the Statement of Ethical Professional Practice. Then I knew what to do. I could not delete or revise the majority of the material that the CEO wanted me to delete. It was relevant for the intended recipients' (the board) decision-making process. And so I "pushed back" to the CEO and cited the IMA's Statement of Ethical Professional Practice as appropriate.

While my professional standards were not compromised, because I eventually did

continued on page 21

[GOVERNMENT]

One More SOX Roundtable | STEPHEN BARLAS, EDITOR

The Securities & Exchange Commission (SEC) will hold its latest Sarbanes-Oxley complaint-fest on May 10 amid some signs that business grumbling about the SEC regulations implementing SOX and the Public Company Accounting Oversight Board's (PCAOB) standards are starting to gain political traction. The SEC held a similar roundtable in 2005, which resulted in the Commission issuing guidance that industry sloughed off as generally inconsequential and short of what is needed. Business groups have complained for the past two years that SOX requirements are too costly, especially Section 404 telling companies how to verify that their internal controls are sound. The PCAOB's Auditing Standard No. 2 (AS2) has also come under heavy fire. Auditors are supposed to "attest" to the soundness of a company's internal controls using AS2, which has been criticized as too inflexible, leading to unnecessary auditor charges. Corporations want the PCAOB to transfer some of the responsibility for attestation to internal auditors, thereby decreasing their need for outside auditors.

> Despite complaints about the PCAOB's legality… the Board hasn't inflicted very much pain on accounting firms.

Interestingly, former PCAOB Chairman William J. McDonough, who left that job last November, was generally unsympathetic to calls for AS2 revisions. But the current replacement, Acting Chairman Bill Gradison, sounded a much more sympathetic note in the press release the SEC issued in mid-February announcing the May 2006 roundtable. "I am very much open to suggestions to make the internal control assessment process more efficient, including modifications of the PCAOB's auditing standard and other actions the Board could undertake," Gradison said. "This is the PCAOB's highest-priority policy issue."

Gradison's public admission that he is open to changes in AS2 was called a "positive change" by David Chavern, vice president of capital markets for the U.S. Chamber of Commerce. Now if SEC Chairman Chris Cox announces he is open to modifications in Section 404, that will be major news.

PCAOB Lawsuit

Gradison's willingness to countenance changes to AS2 may be nothing more than a canny political move to deflate pressure on the PCAOB caused by a lawsuit filed in January by the Free Enterprise Fund, a think tank headed by political conservatives Jack Kemp, Arthur Laffler, and others. The lawsuit argues that the PCAOB exercises wide-ranging governmental powers with little oversight, violating the Constitution's separation of powers. It also states the PCAOB is unconstitutional because its members are

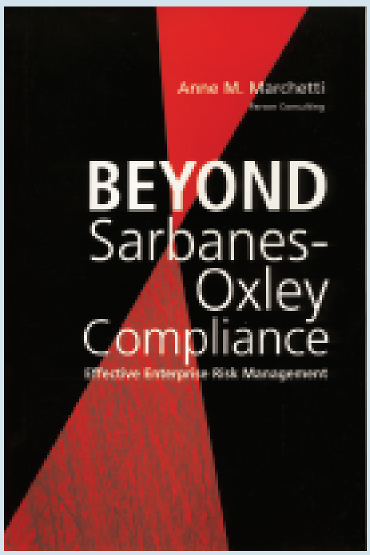
continued on page 21

[BOOKS]

SOX as Opportunity

Most management accountants regard the new internal control and attestation requirements brought by the Sarbanes-Oxley (SOX) Act of 2002 with disdain. Not only are they time-consuming, but they're expensive to implement. A 2004 Financial Executives International study suggested that compliance with Section 404 of SOX (attestation by the external auditor of company internal controls) alone will cost larger firms an average of \$2,241,350, assuming \$50 per hour for staff time and \$100 per hour for external consultant time. It's no wonder that many firms believe the new reporting requirements to be a necessary evil.

Prior to the early 1990s, financial management's emphasis was on "value-added" activities like top-line initiatives, strategic acquisitions, and operational improvement, with internal control regarded as a secondary activity. COSO and the Treadway Commission, codified by SOX, turned that around, putting internal control front and center. Traditional management activities could still be carried out, but management and external auditors had to turn their attention to the existence and functioning of proper internal controls to provide meaningful and accurate financial statements.



In *Beyond Sarbanes-Oxley Compliance*, Anne Marchetti maintains that compliance with SOX shouldn't be looked at as a burden but as an opportunity to improve financial reporting and operating efficiency. She devotes several chapters and detailed appendices on actual implementation, but observes that for many firms the compliance process ends with certification of internal control systems. Marchetti notes that there are additional steps that can make the exercise of complying with SOX pay for itself many times over: the monitoring and continuous improvement of the financial system, especially in light of Sections 302 (management responsibility for and attestation of internal control) and 404. Marchetti argues that, instead of being just another reporting requirement, firms should regard SOX requirements as an outline of best practices for implementation of internal control that guides corporations to turn the myriad activities of the modern economy into accurate, comparable accounting information. Firms that view the law as an opportunity to improve internal controls and their public reporting will ultimately be better run and more attractive to investors.

Compliance with Sarbanes-Oxley can be looked at as an opportunity for continuous improvement of financial reporting, much as Six Sigma leads to continuous improvement of operations. Marchetti emphasizes that compliance must become a mind-set of the entire finance department, starting with top financial management. The "tone at the top" has been mentioned before and serves as encouragement to staff to establish a habit of questioning, documenting, and monitoring on an ongoing basis in the face of changing conditions. It's possible to comply with SOX on a quarterly and annual basis, but to do so on a continuous basis will be more cost effective and provide the firm with guidance it needs to meet changing business conditions.

While the Sarbanes-Oxley Act of 2002 is having widespread repercussions in the United States on exchange-listed and nonlisted firms alike, its requirements are spreading to other nations. The Act requires that foreign branches of U.S. firms comply with it as well as foreign subsidiaries operating in the U.S. In the European Union, the International Accounting Standards Board (IASB) on March 31, 2004, released a comprehensive set of accounting standards, the International Financial Reporting Standards (IFRS), intended to give investors and other stakeholders access to

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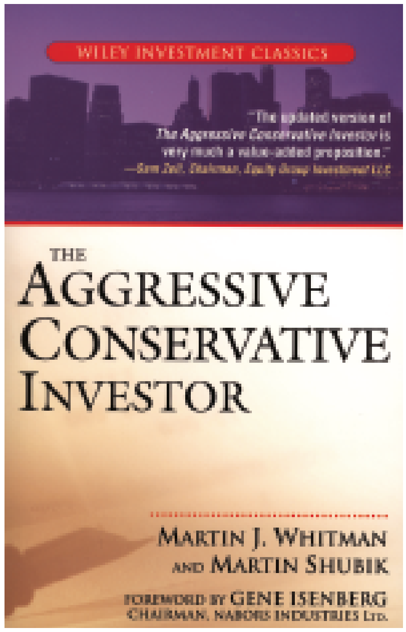
[BOOKS] *cont'd from p. 19*

financial information that can be compared across international boarders. The IASB and the U.S. Financial Accounting Standards Board are working on convergence of IFRS with U.S. GAAP and Sarbanes-Oxley requirements to make financial reporting comparable worldwide. Meanwhile, many foreign firms are seeing the advantages of SOX compliance as a competitive advantage and are attracting investors by showing their financial statement comparability with similar firms in the U.S.

The Sarbanes-Oxley Act of 2002 requires management to shift focus to ensure the existence and effectiveness of internal controls that make financial statements comparable with those of other similar companies in the U.S. and, eventually, the rest of the world. The real value of SOX compliance, however, is the fostering of a new mind-set of continuous improvement to meet the reporting needs of a changing business environment. As Marchetti explains, companies can comply with the Act periodically or they can comply continuously, leading to better reporting, greater efficiency, and lower compliance costs in the long term.—*Mike Osheroff, osheroff@wa-net.com.*

Classic Investment Advice Updated

Investors and creditors who hope to obtain more satisfactory long-term results and a higher total return than could be obtained using other investment methods might want to read *The Aggressive Conservative Investor*, by Martin J. Whitman and Martin Shubik. Originally published in 1979 and reprinted with a 2005 Foreword and Introduction, this Wiley Investment Classic details conservative methods of investment that minimize risk for security holders and is just as relevant and



vital today as when it was first published.

Whitman and Shubik's basic thesis is described as the "financial-integrity" or "safe and cheap" approach. The secret to success isn't to obtain superior (or earlier) information, but rather to use the available information in a superior manner. This strategy for selecting attractive investments has these essential characteristics:

- The company has a strong financial position that is measured not so much by the presence of assets as by the absence of significant encumbrances.
- The company is run by reasonably honest management and control groups, especially in terms of the interests of outside security holders.
- There is a reasonable amount of relevant information akin to full disclosure available to the investor.
- The purchase price for the equity security is below the investor's reasonable estimate of net asset value.

The authors place more focus on fundamental analysis, not technical analysis. The "magic formula" for investment success—the understanding of a business—has to grow out of experience, insight, and maturity of judgment. Financial position is normally the more fundamental factor because it is a better aid than reported earnings in understanding the business. Primacy-of-earnings concepts appear to be more limited in applicability. Book value is a highly useful analysis tool for a variety of purposes, including predictions of future accounting earnings and as a measurement tool for the resources available, potential liquidity of a business, and any competitive investment edge.

Whitman and Shubik go against conventional wisdom and many academic theories and have modified many of their beliefs since the original 1979 book. Their philosophy ignores price fluctuations for securities and other market risks. They no longer believe that all, or even most, markets tend toward instantaneous efficiency. Efficiency assumptions are, at best, of marginal relevance to real-world financial and corporate analysis of equities. They now believe that a strong financial position consists of a combination of a relative absence of liabilities, the existence of high-quality assets, and free cash flows from operations available for shareholders. The concept of general risk is meaningless to a safe and cheap analysis. Investment risk (something going wrong with the company or securities covenants) should be guarded against while market risk (price fluctuations of securities) is of little concern. One thing that differentiates their approach is that the value of a business may not have any short-term relationship to the price of its common stock.

All professional and amateur investors looking to develop a strong investment strategy or anyone looking to incorporate into a portfolio some useful ideas that create long-term value would find this a must-read. The themes of the book are appropriate for the analysis of workouts and special situations as well as for cash-return investing. These are useful for the financial activists such as investment bankers, arbitrageurs, venture capitalists, company management, and control shareholders. This book is a valuable successor to the Graham and Dodd investment classics.

Whitman and Shubik have been principals and independent directors since 1984 of two mutual funds (Equities Strategies Fund and Third Avenue Value Fund) that follow the safe and cheap approach to investing in securities. Third Avenue Value Fund has been a member of the *Forbes* Mutual Fund Honor Roll for three of the last four years and is described as a "deep-value investor… [with] eclectic holdings. [It] likes cheap and safe companies with low debt and strong balance sheets." Both authors also have extensive experience in financial consulting, money management, general brokerage, and teaching finance and economics as members of the faculty at the Yale Graduate School of Organization and Management. Whitman is, in my opinion, an investment guru in the same league as Warren Buffett, Peter Lynch, and George Soros.—*Lance A. Thompson*

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

publish a final report that was materially accurate, I don't believe it was shared with the board. This was a real eye opener for me as a new IMA member. Thank you for supporting our ethical professional practices.

Name withheld by request

[GOV'T] *cont'd from p. 18*

appointed by the SEC, not the President. "People exercising this kind of independent authority should be appointed by the President and confirmed by the Senate," says Michael Carvin, a partner at Jones Day and a former Justice Dept. official in the Reagan era.

The PCAOB is required to inspect once a year the work of auditing firms who have more than 100 public company audit clients. But since its creation, the Board has focused mostly on the Big 4 auditing firms. Despite complaints about the PCAOB's legality and the overreaching of AS2, the Board hasn't inflicted very much pain on accounting firms. No one has been fined. There have been four disciplinary actions against very small firms, where an accountant was tossed out of the business. But the Big 4 have been untouched by the PCAOB's lash. This may explain why the Chamber's Chavern says that while his group has no problem with the Free Enterprise Fund going ahead with its lawsuit, "It is really not consistent with what we want to accomplish."

Senate to Turn to Credit Rating Agencies

The first thing Sen. Richard Shelby (R.-Ala.) mentioned when running down the issues his committee would tackle in 2006 was credit rating agency reform. That issue came up in the House last year but didn't go very far, maybe because the leadership of the House Financial Services Committee knew Shelby, chairman of the Senate Banking Committee, had no intention of moving forward. But Shelby says he is now ready to go.

The House bill introduced last year—the Credit Rating Agencies Relief Act of 2005 (H.R. 2990)—was aimed at establishing competition to the two giants, Moody's and Standard and Poor's, who failed to predict the corporate financial disasters at Enron and WorldCom. Moreover, increasing the number of rivals would tend to decrease costs to corporations who have their bonds rated for soundness. ■

[NEWS] *cont'd from p. 17*

that's the case. And they want to have made significant progress on joint projects where current accounting practices of U.S. GAAP and International Financial Reporting Standards (IFRS) need to be improved.

As far as short-term projects, the FASB will examine the topics of fair value option, investment properties, research and development, and subsequent events. The IASB will examine borrowing costs, government grants, joint ventures, and segment reporting. Joint projects will examine impairment and income tax. For more information and a copy of the MOU, visit the FASB at www.fasb.org and the IASB at www.iasb.org.

Managing Fraud Risks

In its Global Economic Crime Survey 2005, PricewaterhouseCoopers found that the threat of economic crime—from simple cases of asset misappropriation to complex accounting manipulation—is plaguing transportation and logistics companies in particular. To help such companies combat fraud, PWC has published a whitepaper titled "Predicting the Unpredictable: Protecting Transportation & Logistics Companies Against Fraud, Reputation and Misconduct Risk."

The whitepaper provides a step-by-step guide on how to develop an effective antifraud program that addresses financial statement, reputation, operational, legal, and strategic risks:

1. Establish a baseline to assess existing antifraud programs and controls and to develop a remediation plan.
2. Conduct a fraud risk assessment.
3. Evaluate, design, and validate operating effectiveness.
4. Address residual financial reporting fraud risks.
5. Standardize process for incident investigation and remediation.

It also details fraud schemes common to that industry, such as

- Financial statement manipulation,
- Misappropriation of assets,
- Unauthorized receipts or expenditures,
- Aiding and abetting fraud,
- Fraud by senior management, and
- Disclosure fraud.

For more information and to obtain a copy of the whitepaper, visit www.pwc.com/transport, and look under the heading "Of further interest." ■