streetwise

BY STEPHEN BARLAS, B. DOUGLAS CLINTON, ROBERT RANDALL , LANCE A. THOMPSON, KATHY WILLIAMS

[NEWS]

ELA Issues Lease Accounting White Paper | KATHY WILLIAMS

The Equipment Leasing Association (ELA) recently issued a white paper on lease accounting that it says is designed "to get beyond the sensational headlines and clarify for regulators, the business community, and the public the realities of how lease accounting works." Titled "Lease Accounting: Separating Myth from Reality. *Are the lease accounting rules as bad as they say?*" and written by William Bosco, a member of ELA's Financial Accounting Committee, the paper is available for free download at www.elaonline.com/accounting/PDFs/LseAcctg0506.pdf.

Since 1995, different groups have been calling for a revision of the standard for lease accounting, which is the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 13, "Accounting for Leases." But there have been numerous myths circulating about the subject, particularly in light of Enron's collapse, that it wants to dispel, the ELA notes. The main part of the white paper presents the issues commonly cited as problems with lease accounting (myths) and corresponding commentary with the author's clarifications (reality). There's also a section on general information about equipment operating leases in the current market environment.

SEC and PCAOB Announce More SOX Implementation Plans

The Securities & Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) last month announced actions they plan to take to improve implementation of Section 404 of the Sarbanes-Oxley Act of 2002 (SOX).

The SEC says it will issue additional guidance for management on how to complete a top-down, risk-based assessment of internal control over financial reporting; work with the PCAOB on revisions of its internal control auditing standard, Auditing Standard No. 2; examine whether the PCAOB inspections of audit firms have been effective in encouraging implementation of the principles outlined in the PCAOB's May 1, 2006, statement; and expects to postpone the effective date of the SEC rules implementing Section 404 for nonaccelerated filers (although all filers will still have to comply). For more information, visit www.sec.gov/news/press/2006/2006-75.htm.

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FAF NAMES LINSMEIER TO FASB

Thomas J. Linsmeier, the Russell E. Palmer Endowed Professor and Chairman of the Department of Accounting and Information Systems in the Eli Broad College of Business at Michigan State University, has been named a member of the Financial Accounting Standards Board.

An award-winning teacher and researcher with particular expertise in financial reporting for derivatives and risk management activities, Linsmeier begins his term July 1, 2006, and continues through June 30, 2011. He succeeds current FASB member Katherine Schipper, whose term expires June 30.

He began his academic accounting career in 1985 at the University of Iowa and in 1994 became an academic fellow in the Office of the Chief Accountant of the SEC. He also served as a special consultant to the SEC, where he was responsible for formulating U.S. disclosure rules for reporting market risks inherent in derivatives and other financial instruments. He has been a member of the accounting faculty at Michigan State since 1999. ■

Letters to the Editor

"Three-Questions Accounting" is questionable...

Regarding the recent article (April) on TOC and throughput accounting (TA), there are serious logic errors representative of other current publications on this topic. The author invites "healthy debate," which explains the reason for my comments.

First, the author defines total variable costs (TVC) inconsistently by stating that variation is related to "...when one more product is sold." Then he states that "...cost variation is directly proportional to the variation in production volume (p. 52)." What about timing differences where an item is produced this month but sold next month?

Second, in the FIAMA example (inset), the company is sacrificing almost 50% of their throughput margin by turning significant amounts of operating expense (OE) into TVC. This weakens their competitive position and makes them vulnerable in aggressive pricing scenarios. Perhaps this decision was made because they don't know their own resource costs. We don't know, and it's apparently not something that TOC can tell us or them.

Third, the author falls into the trap of confusing the operational cost concept of fixed costs with the decision cost concept of unavoidable costs. This is revealed by the comment, "If TA assumed that OE was fixed, it wouldn't have to answer the question: 'What impact will the decision have on the company's OE?' (p. 55)." The

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[GOVERNMENT]

New Take on Ill Effects of Sarbanes-Oxley | STEPHEN BARLAS, EDITOR

The Sarbanes-Oxley Act (SOX) is keeping foreign companies from listing IPOs on U.S. stock exchanges. That's the new front in the war against SOX opened up by former Secretary of Commerce Donald Evans when he testified about U.S. competitiveness before the House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises on April 26. Up until now, the big knock against SOX over the past two years has been that the law takes a "cookbook" approach to corporate internal controls and outside auditor attestation of those controls, imposing unnecessary corporate costs. But Evans, who is now chief executive officer of the Financial Services Forum, a group of 20 CEOs of the U.S.'s largest financial services companies, went beyond that criticism. In fairness, Evans noted that the Nasdaq, the S&P 500 Index, and Dow Jones Industrial Average are all near five-year highs, which he attributed to increased consumer confidence in the markets, maybe partly as a result of SOX. That was the good news. But Evans dropped some bad news on the committee, too. That had to do with diminished IPO activity in the U.S. For example, in 2005, 23 of the 25 largest IPOs didn't list in the U.S. In 2005, the U.S. accounted for 20% of worldwide IPO proceeds, down from 35% in 2001.

Marsh Carter, chairman of the NYSE Group, Inc., also cited the IPO data to make a different point. "When companies today are required to reconcile their accounts with U.S. GAAP when they list in the U.S., many balk at what they consider needless and costly redundancies in reporting," he said. "While the [Financial Accounting Standards Board (FASB)] and [International Accounting Standards Board (IASB)] have made significant progress towards reconciling U.S. GAAP with international accounting standards, to date, the progress has been mostly incremental and failed to reduce costs significantly."

Cox Stresses Accounting Simplification

When he appeared before the Senate Banking Committee a few days before Carter showed up at the House subcommittee, Securities & Exchange Commission Chairman Chris Cox didn't mention reconciliation of U.S. GAAP with international standards, much less Carter's criticism about lack of a "target date yet for true convergence of U.S. and international accounting standards." But Cox did emphasize the SEC's current drive to simplify corporate financial disclosure. Actually, he promised "an all-out war on complexity." Cox isn't so much concerned about the time and cost involved in preparing 10-Ks and the like. He is more concerned with, as he termed it, "the ordinary investor," who, he said, "inevitably will suffer" from the failure of public companies to use "plain English." The SEC is mostly prodding the FASB on this score. Cox mentioned the standards he believes are most in need of reworking: consolidations policy, certain off-balance-sheet transactions, performance

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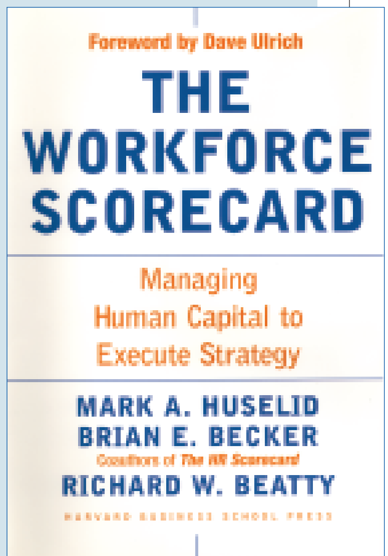
[BOOKS]

The Successful Workforce

In most businesses, workforce success is both the most important and most underperforming asset that CEOs and senior managers can influence directly. Workforce management is the most important element of organizational capital because it constitutes the strategic lever with the greatest opportunity for improved performance. As firms compete more and more for knowledge capital and "brainware," an organization's workforce is its single most important renewable source of competitive advantage. The right human resources (HR) management systems can enhance strategic capabilities, in turn driving firm success.

The Workforce Scorecard, by Mark Huselid, Brian Becker, and Richard Beatty, offers specific, concrete guidance on what matters most with HR investments. These investments should help execute strategy through the culture, mind-set, capabilities, and behaviors created. The aim of the book is to bridge the gap between the development of a business strategy and its implementation through people—in other words, how strategy can be successfully executed. The related scorecard becomes a dashboard for gauging a firm's strategic success. The authors' core finding is that meaningful improvements in high-performance HR management systems can produce a 10%-15% increase in shareholder value.



There are three main challenges for successful workforce measurement and management:

1. Perspective. Do managers understand how workforce capabilities and behaviors drive strategy execution?

2. Metrics. Have the right measures of workforce success, leadership, and workforce

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[IMA NEWS]

Glen E. Woodson, 1925-2006

Glen E. Woodson, former president of the National Association of Accountants (now Institute of Management Accountants (IMA®)) died at his home in Lake Placid, Fla., at the age of 81.

Born in Cleveland, Ohio, Woodson served in the Army during World War II and earned a B.S. degree in accounting from Kent State University after he was discharged. He held accounting and financial positions at Ford Motor Co., SKF Industries, and Libby-Owens-Ford before moving to Arnold Graphic Industries in 1969 as vice president of finance and administration.

When Woodson and two friends formed their own business forms company in 1971, it became apparent that he wasn't just a crackerjack accountant but also a natural entrepreneur. He went on to start other businesses, building their value up and then selling them.

The secret to his success, as he told *Management Accounting* when he was elected president, "I always felt I had a little bit of marketing inside me—that does not make me the typical accountant…You've got to be able to roll the dice a little bit. If you can't do that, then you probably shouldn't make the move into your own specific business."

Woody, as he was known to his friends and colleagues, joined the Akron Chapter of the Association after graduation from Kent State. Chapter members elected him president for the 1960-1961 term, where he led his chapter to victory, winning the Steven-

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[BOOKS] *cont'd from p. 27*

behaviors; workforce competencies; and workforce culture and mind-set been identified?

3. Execution. Do managers have the access, capability, and motivation to use the data to communicate strategic intent and monitor progress toward strategy execution?

Firms need a business strategy, a workforce strategy, and a strategy for the HR function. These strategies are operationalized in the balanced scorecard, the workforce scorecard, and the HR scorecard, respectively. The workforce scorecard, as described by Huselid, Becker, and Beatty, encompasses the following dimensions:

♦ **Leadership and workforce behaviors.** Do the leadership team and workforce consistently behave in a way that will lead to achieving the strategic objectives?

♦ **Workforce mind-set and culture.** Does the workforce understand the strategy and embrace it, and does the necessary culture exist to support strategy execution?

♦ **Workforce success.** Has the workforce accomplished the key strategic objectives for the business?

♦ **Workforce competencies.** Does the workforce have the skills to execute the strategy, especially in the key positions?

The thrust of the basic model is that business strategy determines the needed culture and mind-set, which help to generate the requisite workforce competencies and behaviors. This, in turn, helps create workforce success. In other words, mind-set and culture enable competencies, competencies enable the right behaviors, and the right behaviors enable workforce success. The challenge is executing the strategy rather than choosing the perfect strategy. The goal of the workforce strategy is to drive effective strategy execution.

The workforce scorecard framework is as much about *managing* workforce success as it is about *measuring* workforce success. The focus is on the strategic performance of employees rather than on the contribution of the HR function to business success. Workforce performance and measurement should emphasize differentiation and strategic impact.

The book contains many case studies and experiences from companies such as IBM, GE (Jack Welch), AlliedSignal (Larry Bossidy/Ram Charan), and anonymous corporations in many industries. It concludes by summarizing the key lessons for creating, managing, and measuring human capital and providing a road map for managers who want to develop more effective workforce measurement systems. A 20-question diagnostic tool is provided to evaluate how an organization's approach to management and measurement of workforce success compares with the book's ideas.

The Workforce Scorecard offers critical insights for executives, senior HR practitioners, academics, and students in HR management strategy. The fundamental distinction is between developing an understanding of the contribution of the workforce versus a focus on understanding the cost of the workforce. This book is recommended reading for all business leaders who want to improve the competitive advantage of their workforce and the successful execution of their business strategies.—*Lance A. Thompson*

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Glen E. Woodson *cont'd from p. 27*

son Trophy in the Association's annual competition. He also served on the boards of the Philadelphia, Greater Youngstown Area, Canton, and Southwest Florida Chapters. Woodson was also elected to national positions, serving four terms as national treasurer and, in 1986-1987, as president.

A popular, eternally optimistic IMA leader, Woody had many friends among IMA members who are saddened by his death. He is survived by his wife of 57 years, Carol; two daughters; a son; and six grandchildren. ■

[GOV'T] *cont'd from p. 26*

reporting, and revenue recognition. The FASB's reworking of those standards will be going on parallel to codification of GAAP. Cox also criticized the proliferation of new accounting pronouncements from multiple sources. The last thing he noted was the need to strengthen the existing conceptual framework for U.S. GAAP in order to provide a more solid and consistent foundation for the development of objectives-oriented standards in the future.

Corporate Taxes and Financial Reports: Two Diverging Roads?

Confusing accounting standards also came into play at hearings last month in the Committee on Ways and Means's Subcommittee on Select Revenue Measures. Rep. Dave Camp (R.-Mich.), chairman of the Subcommittee, is concerned that the U.S. has a high corporate tax rate but raises a relatively low amount compared to other members of the Organization for Economic Cooperation and Development (OECD). This leakage of revenue may have something to do with the fact that reporting requirements for income taxes are rapidly diverging from parallel requirements for purposes of financial reporting. A spokesman for the committee said that Camp has no remedial legislation in his pocket—at least not yet.

Extension of Corporate Tax Preferences

Talking about corporate taxes, the extension (and enhancement) of some expiring key corporate deductions is being held up by the House and Senate's continuing inability to agree on a $70 billion tax cut bill. The House passed a tax cut extension bill last December; the Senate followed with a different version in February. Those divergent bills have been waiting for a House-Senate conference committee to resolve the differences ever since. A tax cut extension bill is important to the business community because it expands the Research and Development (R&D) Tax Credit and the Work Opportunity Tax Credit, which expired in 2005. The bill also has a number of individual tax provisions, such as extending the 15% rate on capital gains and dividends. That rate doesn't expire until the end of 2008, but an early extension is seen by Republicans as a big political plus for their base in what is shaping up to be a very uncertain political climate for the GOP. The business provisions are seen as somewhat less important, particularly given the huge federal deficit. To break the logjam, the R&D tax credit expansion may be placed in a separate bill, whose legislative prospects would be a touch uncertain. ■

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

The PCAOB announced its own four-point plan to improve SOX Section 404 implementation. It says it will amend AS No. 2 to ensure that auditors' primary focus during an integrated audit is on areas that pose higher risk of fraud or material error, to clarify materiality and scoping decisions and the definitions of significant deficiency and material weakness in internal control, and more. The Board will also reinforce auditor efficiency through PCAOB inspections (the inspections of registered public accounting firms will focus on the firms' efficiency in conducting internal control audits). And it will develop implementation guidance for auditors of smaller public companies. For more information, visit the PCAOB website at www.pcaob.com/News_and_Events. ■

[LETTERS] *cont'd from p. 26*

assumption that all fixed costs are unavoidable for all decisions is invalid. This is a widespread error that has been committed by both educators and practitioners.

Fourth, capacity analysis is ignored by the article as are the costs associated with it. In the case of Example A, how does the company know that they have idle capacity? No evidence is presented that the throughput accounting system can tell them that information, although the claim is made that it can, regardless of whether a constraint exists (p. 55). Assumed capacity levels are present in all of the examples presented.

To be clear—there are three questions presented, but the last two are apparently not answerable by the TA/TOC method for decisions other than incremental change within the relevant range. Thus information to address OE and investment is not necessarily provided by TA/TOC or 3QA. In this regard, it is frustrating that the author concludes by stating, "We need to know where the company does and doesn't have flexibility to increase volume and/or variety of products. This is something TOC and Lean are quite good at..... And this is exactly what TOC's management accounting system does (p. 55)." Apparently we are expected to use TOC to address these issues, but can we? With TOC, as soon as a company experiences a decision that goes beyond the relevant range they have a problem. Either no mechanism is available for the analysis of fixed cost step functions and investments, or these items remain unexplained by the article.

Finally, TOC is referred to as a "management accounting system...," an assertion that seems overly ambitious given the host of decisions for which it apparently cannot provide adequate decision support information.

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