streetwise

BY STEPHEN BARLAS, PAUL L. SHILLAM, KATHY WILLIAMS

[NEWS]

How Useful Are Financial Reports? | KATHY WILLIAMS

Efforts to improve the financial reporting process in the last few years have resulted in advancements in three key areas: corporate governance, the process of preparing financial reports, and the audit of financial reports. But the understandability and usefulness of the actual financial reports haven't improved. These are the main results of a global survey of participants in the financial reporting supply chain commissioned by the International Federation of Accountants (IFAC) last year. The survey report, *Financial Reporting Supply Chain: Current Perspectives and Directions*, was released last month.

Regarding corporate governance, respondents said that it has improved because of an increased awareness that good governance counts, changes to company codes and standards, improved board structures, improved risk management and internal control, and increased disclosure and transparency. But participants also cited some areas of concern, such as governance in name but not in spirit, development of a checklist mentality, overregulation, and personal risk and liability for directors and management.

Respondents said that the financial reporting process has improved because of convergence to a single set of global financial reporting standards, improvements to regulations and oversight, boards of directors and management taking ownership of financial reporting, improved internal control over financial reporting systems, and improved technology for preparing financial reports. Concerns in this area included the costs of transitioning to International Financial Reporting Standards (IFRS), the need to comply or to reconcile accounts with more than one set of financial reporting standards, the complexity of financial reporting standards, and litigation risk.

Audits of financial reports are better because of improved auditing standards and processes; increased awareness, commitment, and competence of auditors and audit committees; more risk-focused audits; greater auditor independence; and improved quality review and auditor oversight,

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IFAC WANTS YOUR RESPONSES

IFAC's Professional Accountants in Business (PAIB) Committee would like professional accountants and others who work in the public sector to complete an online survey on the ways in which public sector organizations set objectives, measure performance, and report on results. The Committee is conducting this survey, it says, because there is so little information available about public sector performance measures around the world.

The survey is part of a project to help professional accountants in business and others evaluate and improve performance measurement systems. It is designed to identify similarities and differences in performance measurement structures and the extent to which they help public sector entities meet their objectives. The Committee also wants examples of strengths and weaknesses of performance measurement structures and what can be done to further improve the assessment, monitoring, and reporting of financial and nonfinancial performance in the public sector.

IFAC says the survey should take about 10 to 15 minutes to complete, and it would like to have responses by April 30. You can access the survey at www.ifac.org/publicsectorperformancesurvey. ■

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the respondents noted. Areas of concern were reduced scope for professional judgment, overregulation, fear of liability leading to boilerplate audits, auditor's communication with external shareholders was limited, fewer audit firms to choose, and increased audit costs relative to perceived benefits.

And what can be done about the usefulness of financial reports? Some of the participants' suggestions were to improve the communications among participants in the financial reporting supply chain (users, preparers, auditors, standards setters, and regulators); produce financial and business information that is relevant, reliable, and understandable; include more business-driven information in financial reports; and promote the use of technology to enable users to compile their own information.

This brief summary of some of the issues just touches on the wide range of findings from the survey and follow-up interviews. To get your copy of the full report, visit www.ifac.org/frsc. ■

We welcome all opinions on articles and departments published in *Strategic Finance*. E-mail correspondence to Kathy Williams at kwilliams@imanet.org.

[GOVERNMENT]

IRS Ruling on Parachutes Lands Softly on Accounting Concerns

STEPHEN BARLAS, EDITOR

The Internal Revenue Service has changed its rules on the deductibility for executive compensation over $1 million a year. But the revenue ruling that the IRS dropped on the business community on February 21 won't create the accounting havoc that some worried it might. That's because the ruling grandfathered in severance packages signed prior to the ruling. Section 162(m) of the Internal Revenue Code (IRC) explains when companies can take more than a $1 million deduction for the pay of any of its top five executives, excluding the CFO. A chief requirement is that the $1 million-plus annual package be based on performance. The IRS issued explanations of how it interpreted §162(m) in 1999 and 2006 that said companies could pay, and top executives could receive, a pro-rated share of a performance-based award even if the executives left the company before the performance period ended and before it was clear those performance goals had been met—as long as the executive left the company as a result of being terminated without "cause" or if he or she voluntarily terminated his or her employment for "good reason."

In its revenue ruling issued on February 21, 2008, the IRS explained that an employee could leave for "good reason" or be terminated without "cause" simply because that employee missed interim performance targets. Therefore, he or she wasn't eligible for performance-based pay, nor could the company deduct that pay over $1 million.

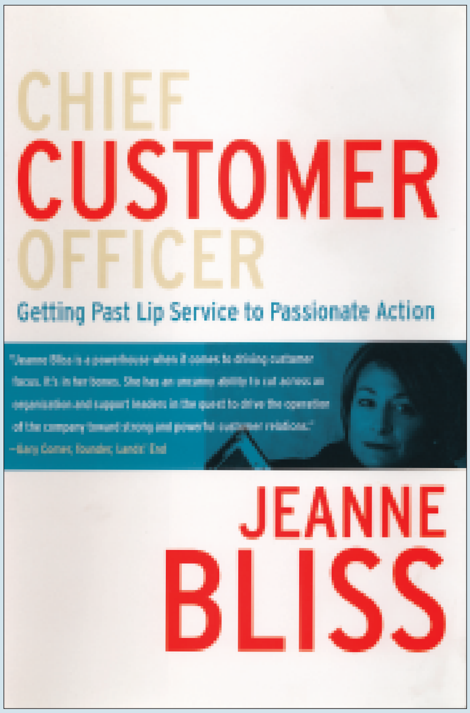
Steve Seelig, executive compensation counsel for Watson Wyatt, says companies now need to examine severance packages to make sure they pay out at target. This raises a couple of possibilities. For example, an employee given an agreement with a three-year performance target who then leaves the company one year into that agreement might be eligible for the bonus at the end of three years if targets are met at that point. Or that same employee might have a severance agreement that entitles him/her to a specific dollar amount if he/she leaves prior to the end of the target period.

Seelig says that although §162(m) explicitly deals with the five highest-paid corporate employees (not including the CFO), the IRS revenue ruling will force companies to also look at severance and bonus packages for lower-ranking employees outside the top five. If a company sets a three-year performance period for its top 10 executives, for example, it won't be clear at the start of the period which of those 10 will be in the "top five" three years later. ■

[BOOKS]

Focus on the Customer

In *Chief Customer Officer*, Jeanne Bliss provides a valuable reminder that the purpose of business is to satisfy the need or want of another. The approach Bliss uses for getting to this point is based on first identifying that the primary focus of an organization should always be the customer. Her indictment is that while the intent of segregating the organization into silos such as marketing, sales, shipping, and operations is to create strong competencies, it cuts the customer out of the process. This is exactly what organizations want to avoid!



Bliss explains that identifying an organization's "power core"—the source of its competitive competency—is crucial to integrating the customer into the organization's customer planning initiative. In building her case for developing a customer focus, she addresses many issues often faced by organizations, such as dueling silos and leadership courage.

One of my favorite chapters in the book is called "Herding C-A-T-S." CATS is an acronym for four key components:

- **C**ustomers gained and lost as a result of the organization's actions ("guerilla metrics"),
- **A**bility to serve customers and rescue customers at risk (service performance),
- **T**argeting and resolving issues driving customers away (customer listening metrics), and
- **S**ilo connectivity and metrics for optimum experience delivery (operational metrics).

The following chapter, "Reality Check Audit," provides a useful tool for assessing an organization's progress in driving customer relationships and profitability. The tool is a self-assessment that leaders can use to drill down into the four components of customer metrics. The leadership group would be well served to complete the assessment and discuss their evaluation in a group to determine the current customer environment within the company and to discuss the steps that might be needed to move to the next level of customer experience.

Bliss devotes the third part of *Chief Customer Officer* to answering the burning question: Is a Chief Customer Officer (CCO) the Solution? Chapter Eight contains a number of questions to help leaders evaluate whether a CCO is needed. Below are some examples of the statements Bliss includes to help leaders answer the question:

- We have a roadmap for the customer work and know where progress will be measured. (Yes or No?)
- Clear metrics exist for measuring progress that everyone agrees to use. (Yes or No?)
- Recognition and reward are wired to motivate customer work. (Yes or No?)

Bliss's advice after completing the assessment is that you decide what's right for your company. She is explicit in her intent when she states, "Finally, this book is meant to offer you a way to frame the organizational challenge to this work and offer food for thought on how you integrate a solution that's right for your company." Through the case studies, self-assessments, and personal experiences, Bliss provides the knowledge, insights, and tools to make an informed decision as to whether it is time to create the position of Chief Customer Officer.—*Paul L. Shillam, CMA, CPA*