SF bulletin

By Stephen Barlas, Grover L. Porter, Lance A. Thompson, Kathy Williams

GOVERNMENT

Derivatives Bill Splits Corporate Community & Obama Administration

By Stephen Barlas, Editor

The Obama administration's Over-the-Counter Derivatives Markets Act of 2009 has split not just the corporate community but the administration itself, apparently. The complex Obama proposal imposes new regulatory requirements on swaps dealers and corporate users of swaps. Suffice it to say, companies such as Cargill who offer hedges to other companies—bakeries and restaurants, for example, in Cargill's case—oppose the proposal. Delta Air Lines, on the other hand, which uses commodity swaps to even out the swing in oil prices, thinks the bill should be even stronger. Apart from smoothing out commodity price swings, the Obama bill would have even broader corporate application given the wide use of swaps in the corporate credit sense. Here the bill would impose significant new requirements on corporate finance departments. Dan Budofsky, a partner of the law firm Davis Polk & Wardwell LLP, who testified on behalf of the Securities Industry and Financial Markets Association (SIFMA), said the bill would effectively require corporate end users to become members of registered clearing agencies. This would lead to the very significant cost of posting margin in the form of cash or cash equivalents, which is the form of collateral required by clearing agencies. "Because these funds would no longer be available for productive investment in the corporate end user's business, a clearing requirement would create a significant disincentive to use swaps to manage risk," Budofsky said. "Today, in the [over-the-counter] derivatives world, corporate end users may be required by their dealer counterparty to post margin, but that margin may be in the form of assets other than cash or cash equivalents." Another example of the Act's potential impact on end users arises in connection with margin requirements. Although regulators aren't required to impose a margin requirement on end-user transactions that aren't cleared, the Act says they *may* do so and *would be required to* if the end user falls within the definition of major swap participant or the transaction doesn't qualify for hedge accounting treatment under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." This means that an extension of credit created through a swap transaction must be collateralized even though most other extensions of credit between the parties could be made on an unsecured basis. Finally, though the bill was written by the Treasury Department, with input from the Securities & Exchange Commission (SEC) and others, SEC Chair Mary Schapiro says the bill is "an important step forward," but "it needs to be strengthened in several ways."

GOVERNMENT

SEC/FASB Report to Congress Passes House

Given the distrust between Democrats and Republicans on Capitol Hill, any bill that passes the House by a voice vote—which means it wasn't controversial—runs the risk of being considered too tepid to matter. That may be the case with the Promoting Transparency in Financial Reporting Act (H.R. 2664) the House passed in September. The bill requires the SEC and the Financial Account-

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ing Standards Board (FASB) to testify annually to Congress on the steps they have taken to reduce the complexity in financial reporting and to provide more accurate and clear financial information to investors.

This is a bill that the House passed in the two previous Congresses only to watch the legislation vegetate in the Senate Banking Committee, which has jurisdiction. The bill never moved an inch off that Committee's docket. Rep. Christopher Lee (R.-N.Y.), who championed the bill in the House this year, thinks the legislative climate is more conducive to Senate passage this year, given the concerns about financial industry accounting and hijinks raised by last year's Wall Street debacle. He's trying to give the financial reporting transparency issue a populist twist—i.e., Americans need better information in order to make decisions about their retirement accounts. Lee also thinks accounting rules could be improved for the sake of easier corporate compliance, which isn't exactly a new thought. He states, "It is critical that we take care to identify the complexities that trip up everyone from small businesses to large corporations and then pursue reforms that may simplify and improve the process." The kinds of things Lee expects the SEC/FASB annual testimony to cover are assessments of complex and outdated accounting standards, increasing the usability of the existing accounting and auditing literature, developing principles-based accounting standards, encouraging the use and acceptance of interactive data, and promoting disclosure in plain English.

WE WANT YOUR STORIES

Has IMA helped you in your career or in a job search? Has serving on a chapter board helped you hone your leadership skills? Has attaining certification helped you in your work as an accounting professional or helped you earn more money? What kinds of experiences have you had in IMA?

If you would like to share stories such as these (and many other types), we would welcome your contribution to the IMA Life column you see at the end of each issue of the magazine. If you would like to write an IMA Life or would like to recommend someone to be featured, please e-mail Kathy Williams at **kwilliams@imanet.org**.

LETTERS

Increase Profits at All Costs

It seems like it was only yesterday that my article about whistleblowers ["Whistleblowers: A Rare Breed"] was published in *Strategic Finance* [August 2003]. Although the article was published more than six years ago, executives of leading organizations (corporations, financial institutions, government agencies) still have not learned their lessons and continue to participate in illegal and/or unethical behavior.

The current recession was caused primarily by executives in organizations who did whatever necessary to increase profits at all costs. Those executives stooped to illegal and/or unethical behavior in their quest to justify their exorbitant salaries and bonuses.

The latest example was the drug giant Pfizer, who agreed to pay $2.3 billion in fines and penalties to settle the largest pharmaceutical fraud case ever pursued by the U.S. Department of Justice. The probe was triggered by whistleblowers who will share more than $100 million for bringing Pfizer's actions to the attention of authorities.

The primary Pfizer whistleblower was John Kopchinski, a U.S. Gulf War veteran and former Pfizer sales representative. Kopchinski said, "In the Army I was expected to protect people at all costs. At Pfizer I was expected to increase profits at all costs, even when sales meant endangering lives. I couldn't do that."

The current *IMA Statement of Ethical Professional Practice* states: "Communication of such [unethical behavior] problems to authorities or individuals not employed or engaged by the organization is not considered appropriate, unless you believe there is a clear violation of the law." Therefore, the current IMA Statement appears to only support whistleblowing for legal violations but not ethical violations. Is that the ethics message IMA needs to communicate to members?

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BOOKS

Driving New Growth

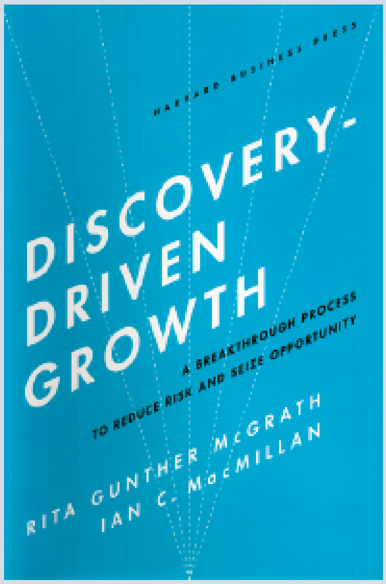
In *Discovery-Driven Growth*, Rita Gunther McGrath and Ian MacMillan write about how companies that use conventional methodologies to pursue exceptional growth are doomed to be disappointed. Techniques that work well for the core business can smother new growth ventures. As a remedy, McGrath and MacMillan outline a set of new practices that allows managers to choose better strategic growth projects, reduce the risk of these projects, and either execute them with relentless success or discontinue them at lower cost. The cornerstone of these practices is discovery-driven planning, through which an organization sets up bold plans to pursue the future it envisions, learns where its true future lies, and tests its assumptions about that future at the lowest possible cost.

McGrath and MacMillan organized *Discovery-Driven Growth* into three main sections:

1. Creating a focus on strategic growth, which involves aligning a company's strategy with resource allocations and project approvals and connecting the growth strategy with specific, actionable opportunities.

2. Executing strategic growth projects, which includes learning to manage actual projects that are the real core of the company's strategy.

3. Making discovery-driven growth (DDG) work, which focuses on weaving DDG into the company's culture.



The discovery-driven approach begins with the recognition that bold but uncertain outcomes aren't predictable. You have to discover new ideas and deliberately redirect the resulting initiatives as events unfold. The challenge is getting directional data quickly enough to make "roughly right" decisions, which requires a very different kind of discipline involving a lot of learning, a lot of change, and a lot of redirection.

With DDG, a company specifies the strategic outcome it desires and then learns its way into its unfolding future. The emphasis is on creating a future strategy that's attractive and realistic, not driving your strategy from your past success. This begins with the assumption that you don't have the answers and that you keep your options open for as long as possible. The key idea is that, as your plan unfolds, you want to be reducing the assumption-to-knowledge ratio. When it is high, there's a huge amount of uncertainty, and learning fast should be prioritized at the lowest possible cost. As the ratio shrinks, focus and resource prioritization become more important.

The discovery-driven approach works because it compensates for three cognitive and emotional biases that can lethally distort decision making in high-uncertainty situations. Confirmation bias leads people to embrace new information that reinforces their existing assumptions and to reject information that challenges them. Recency bias and human cognitive limits lead us to forget that we made assumptions in the first place, making it nearly impossible to learn from our unfolding experiences. The "winners' curse" causes us to overvalue winning in a competitive situation, even to the point that the price we'll pay exceeds the value of the prize.

Discovery-Driven Growth has been proven to be effective in a broad range of organizational contexts and is especially useful for executives, managers, staff personnel, consultants, organizational change agents, and all entrepreneurs who are interested in growth and innovation.—Lance A. Thompson, Thompson Management Consulting Services, LLC, lancephx@aol.com