SF bulletin

By Stephen Barlas, Alfred M. King, Lance A. Thompson, Kathy Williams

GOVERNMENT

Changes to SOX 404B Up for Discussion

By Stephen Barlas

Changes to Section 404B of the Sarbanes-Oxley Act (SOX) may be in the offing as part of an "improving access to capital" bill starting to germinate in the House. One of the elements absent from President Obama's jobs proposal is anything improving the access to capital for small and medium-size businesses, who are the job creators in the United States. The House Committee on Financial Services will attempt to rectify that oversight by moving five separate bills, one of which would expand the exemption in SOX Section 404B, which requires companies with market caps over $75 million to have auditors actually audit those companies' internal controls through testing. Rep. Stephen Fincher (R.-Tenn.) has a bill—one of the five capital formation bills the Financial Services Committee is considering—that would increase the exemption that was raised to $75 million by the Dodd-Frank Act. Fincher's bill, called The Small Company Job Growth and Regulatory Relief Act, would raise the exemption to $500 million and, in certain cases, as high as $1 billion. His thought is that companies are staying out of the capital markets because of the reputed costs of complying with Section 404B.

Rep. Scott Garrett (R.-N.J.), chair of the Capital Markets and Government Sponsored Enterprises subcommittee within Financial Services, says the Fincher bill is one he is "really interested in." There is a good chance the Fincher bill will be included in a "capital formation" package reported out of committee. But Rep. Barney Frank (D.-Mass.), the top Democrat on the full committee, says that although he agrees with a number of the capital formation bills proposed by Republicans, he is "less enamored" of the Fincher bill. That view is also held by Rep. Carolyn Maloney (D.-N.Y.), who points out that the $75 million exemption covers 60% of the businesses in the U.S. Fincher may get some support from committee Democrats such as Rep. Jim Himes (Conn.), who says he is "open that Sarbanes-Oxley is not perfect." Some Democratic support for the Fincher bill in the Republican-controlled House will be important if the bill is to pass in the Senate, where Democrats hold the majority.

Meredith Cross, director of the Division of Corporation Finance at the Securities & Exchange Commission (SEC), says that 80% of U.S. companies would be relieved from compliance with Section 404B if the exemption threshold is raised to $500 million. As part of the requirements of the Dodd-Frank Act, the SEC staff examined the pros and cons of increasing the exemption to $250 million. It recommended against the increase.

SEC May Be Rethinking Reporting Requirements for "Conflict Minerals"

The SEC held a roundtable on October 18 to receive additional comments on the Dodd-Frank requirement that companies provide details in their financial reports about their use of "conflict minerals." This requirement was almost an afterthought, appearing in the last 10 pages of the almost 900-page Dodd-Frank bill. But business groups have assailed the provision, and the SEC's initial thoughts on implementation, which it may now be reconsidering, especially given a federal appeals court's overturning this past summer of the SEC's final shareholder proxy access rule. Dodd-Frank requires companies who obtain tin, tantalum, tungsten, gold (and other minerals determined by the U.S. Secretary of State) in the Democratic Republic of the Congo and adjoining countries to file three different forms of paperwork with the SEC and to publish a "Conflict Minerals Report" in their annual report and on their website.

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The SEC issued a proposed rule last December, and then extended the comment period once, to March 2, 2011. That's where things stood until the announcement of the roundtable. The SEC estimated that the cost to companies of putting together the required financial reports was $71 million. The National Association of Manufacturers estimates compliance costs will fall between $9 billion and $16 billion. In a report it issued on October 4, the Brookings Institution, not normally considered a bastion of pro-business support, said, "It is reasonable to expect the SEC will be mindful of certain complicating factors that could unnecessarily escalate compliance costs for companies already struggling under trying economic times."

LETTERS

Single Biggest Step

In 47 years as a member I have seen a number of notable highlights at IMA®. When the Conceptual Framework project, described in the October 2011 issue, is accomplished, this will be seen as the single biggest step we will have taken since the introduction of the CMA® program in 1972.

The Task Force members make a compelling case why IMA should develop a Conceptual Framework for Managerial Costing. Readers should keep in mind that IMA was originally founded as the National Association of Cost Accountants. Things change, and the original emphasis on cost accounting became subsumed in many other initiatives, such as Ethics, Organizational Behavior, and Budgeting.

Yet our Institute's roots remain in Cost Accounting. The authors make a compelling case that there are many different "flavors" of Cost Accounting, but no overarching framework. Such a framework, if established, would substantially enhance the credibility of Cost Analyses and Management Accountants both to senior management *and* to outside stakeholders.

The missing links in the Task Force report are (1) a specific timetable, (2) an estimate of resource requirements, and (3) an indication of *who* will be charged with the development of at least the first draft of a Conceptual Framework.

Realistically this will be a two- or even three-year project. But, as the Chinese proverb has it, "The longest journey starts with a single step."

Let us, as an Institute, take that first step very quickly.

Alfred M. King (CMA #23)

We welcome all opinions on articles and departments published in *Strategic Finance*.
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***Strategic Finance* and *Management Accounting Quarterly* are now part of the *LinkUp IMA* online community.**
Join the IMA Publications Discussion Group at http://linkupima.com/groups/c8c9e0e5b9/summary.

Sharing Your IMA Life

Most IMA® members share a strong spirit of camaraderie. What have your experiences as a member of IMA been like? Do you have a story about them you'd like to share? If so, please consider writing an IMA Life column that will be published in *Strategic Finance*. You can be a student member, a young professional, in the midst of your career, or retired. If you would like to write an IMA Life article, please e-mail Kathy Williams at kwilliams@imanet.org.

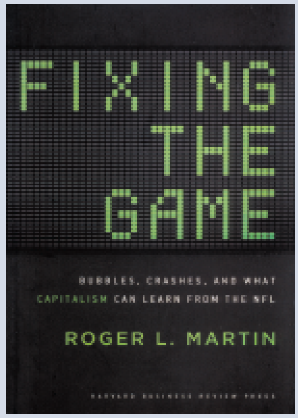
BOOKS

Rethinking Business

In *Fixing the Game*, Roger Martin proclaims that our theories about shareholder value maximization and stock-based compensation are flawed and have the ability to destroy our economy. These theories have led us down a path to greater volatility, less long-term value creation, and minimal authenticity. Martin believes we need to embrace a different conception of business that includes a new model for aligning the expectations and real markets, executive compensation, and new structures that support authenticity and meaning.

The real market is the world in which factories are built, products and services are designed and produced, revenues are earned, expenses are paid, and profits are generated. This is the world that executives control. The expectations market is the world in which shares in companies are traded between investors. Investors assess the real-market activities of a company and form performance expectations that determine stock prices. Expectations are where the money is for shareholders and most executives.

Martin argues that the difference in outcomes between a real-market world and an expectations-market one stems directly from the way we have linked the two markets, amplifying the influence of the expectations market on the real market. When the real market is dominant, customers are the focus and the central task of companies is to find ever better ways of serving them. The real market produces a positive-sum game for society. In contrast, the expectations market produces a gigantic zero-sum game where players compete against one another to split up a defined, finite pie. Traders are the focus, and gaming markets is the task.



Martin recommends five positive steps in *Fixing the Game*:

1. Shift the focus to the customer and away from shareholder value—to the real market and away from the expectations market.

2. Restore authenticity to the lives of our executives—an increased emphasis on the customer and rethinking executive compensation to focus on meaningful goals.

3. Address board governance by fundamentally rethinking the role and structure of boards.

4. Regulate and manage market players more effectively, most notably hedge funds and pension funds.

5. Provide executives with a framework that enables them to think about the greater role of business in society.

The primary objective of these steps is to turn companies from attending in vain to the expectations market toward focusing on the real market and its customers. Customer delight is a more powerful objective than shareholder value. A business must choose as its primary goal between shareholder value (subject to meeting a basic customer value hurdle) and customer value (subject to creating a minimally acceptable level of shareholder value).

Martin presents a compelling case as to what the consequences are of our current theories of capitalism. His recommendations for new theories are sound, broad-based, and include all major company stakeholders (executives, boards of directors, business employees, shareholders, and society). Martin uses the practices of Procter & Gamble, Apple, Johnson & Johnson, and the National Football League as examples of explicitly putting customers before shareholders.

Fixing the Game is excellent, and Martin describes the problems and proposed solutions in a clear, insightful manner that forces us to reflect and critically think about new theories of capitalism for American and global companies. This book is highly recommended for academia, business students, business executives, boards of directors, and the investment regulatory agencies.

—Lance A. Thompson, Thompson Management Consulting Services, LLC,
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