

SFbulletin

By Stephen Barlas, Jeroen Bos, John M. Brausch, Greg Krippel, William E. McKinley, Sheila Mitchell



GOP Pushes Expansion of 404(b) Exemption

By Stephen Barlas

The prominent role played by regulatory issues in the November elections gives added visibility to legislation further relaxing the Sarbanes-Oxley Act (SOX). Look for Republicans in the House to bring to the floor a bill, H.R. 6161, that adjusts the definition of “accelerated filers” in a way that permanently relieves companies with public floats less than \$250 million or annual revenues less than \$100 million from having to comply with SOX Section 404(b), which requires a company’s auditor to attest to the effectiveness of the company’s internal controls.

Rep. Mike Fitzpatrick (R.-Pa.) is the prime sponsor of H.R. 6161. It goes beyond the Jump Start our Business Startups Act (JOBS Act) that President Obama signed in April. That bill says “emerging growth companies” don’t have to comply with Section 404(b). In 2010, Dodd-Frank provided a permanent exemption from Section 404(b) compliance for nonaccelerated filers, i.e., those with a public float less than \$75 million. Then the JOBS Act extended the exemption to “emerging growth companies,” provided their revenues remain below \$1 billion and their public float stays under \$700 million. That exemption was only good for five years, and many Democrats supported it. The idea was to make it more enticing—by ditching 404(b)—for a private company to go public, thereby enabling it to attract capital and create jobs.

But many Democrats who backed further easing of Section 404(b) are probably going to think twice about taking another step down that path, especially if they listen to John C. Coffee, Jr., the Adolf A. Berle Professor of

Law at Columbia University Law School. At hearings in the House Capital Markets and Government Sponsored Enterprises Subcommittee at the end of July, Coffee described H.R. 6161 as the Mature Mediocrities Act. “The JOBS Act’s provision can thus be justified as a transitional provision for young companies,” he said. “In contrast, H.R. 6161 would extend permanent immunity from SOX’s Section 404(b) to firms that stayed below \$250 million in their public float. Whatever the case for sheltering emerging growth companies for a limited period, it is far stronger than the case for immunizing ‘Mature Mediocrities’ forever, as H.R. 6161 would do.” Coffee estimated that a minimum of 1,000 companies would get out from under Section 404(b) if H.R. 6161 passes.

In contrast, Jeff Hatfield, president and CEO of Vitae Pharmaceuticals, testified at the same hearing on behalf of the Biotechnology Industry Organization. He said, “If we decided to go public, it would cost us roughly \$1 million annually to comply with SOX Section 404(b). This cost would be borne entirely by our investors.”

Congress Likely to Clarify Dodd-Frank “End-User” Derivatives Exemption

Though there appears to be very limited Democratic support for expanding the SOX Section 404(b) exemption beyond the JOBS Act provision, there is support in Congress from both parties to relieve nonfinancial companies from some of the derivative requirements of the Dodd-Frank Act. Action turns to the Senate this fall on a bill clipping the wings of the Obama Administration on its rulemaking that defined when nonfinancial companies have to post “margin” when entering into derivative trading arrangements with coun-

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BOOKS



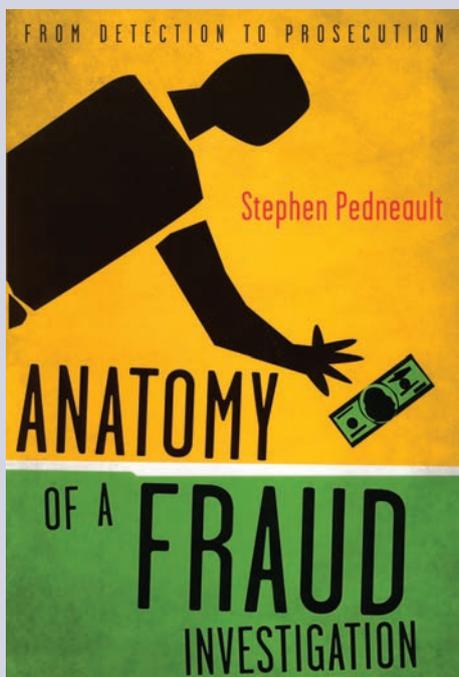
Dealing with Fraud

Accountants generally aren't forgiving of ethical lapses. As professionals—and certainly as IMA® members—we adhere to a clear code of ethical professional practice and take those guidelines very seriously. But not everyone is bound by the ethical moorings of our profession, and fraud, in its many guises, occurs every day. Accountants would do well to be aware of this and know what to do if a fraud is suspected or perpetrated.

This is one of the key points of Stephen Pedneault's book, *Anatomy of a Fraud Investigation*. One part true-story crime drama and one part fraud reference book, Pedneault's book takes the reader through an entire fraud investigation, following the same principles as the old television show *Dragnet*: just the facts, ma'am, with names changed to protect the innocent and the guilty.

Anatomy of a Fraud Investigation reads like a novel, but it's also interspersed with learning points and fraud facts that are boxed-off for easy recognition and to separate them from the story. The story is approximately 75% of the book, with the learning points and fraud facts comprising the remaining 25%.

Any reader looking for a crash course in fraud and fraud prevention could read through the learning points and fraud facts in a couple of hours and walk away understanding a great deal more about



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fraud and investigating fraud. Some of the facts that stood out to me were how fraud is generally detected: 46% by an anonymous tip and 20% by accident. Both numbers emphasize how important it is to educate employees regarding their fiduciary duty to provide informa-

tion as well as the organization's obligation to provide a means to do so. Another eye opener was the list of top 10 passwords used and where you might find them. Key learning points included the importance of the chain of custody in protecting evidence, the best way to handle the ensuing police investigation, and the importance of the smallest details in convicting the criminal.

I learned a lot from the technical parts of the book, but the underlying story was riveting as well. It involves a nonprofit organization where a large fraud has been perpetrated. One individual is suspected initially, but the ensuing drama reveals the involvement of others. Pedneault takes the reader on a journey of discovery from the first hint of fraud, what to do next, meeting the players (and personalities) involved, how the evidence was gathered, and the difficulty in obtaining a conviction. The story provides excellent lessons for the reader: While the organization made many of the right moves in handling the situation, it also made some glaring mistakes that made it much more difficult to prove the case. *Anatomy of a Fraud Investigation* is a great place to begin studying fraud, and it will surely whet your appetite to learn more.

—John M. Brausch, president of J Brausch and Co. and former IMA Chair, jbrausch@imanet.org

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terparties, usually big banks. Dodd-Frank said that non-financial companies who use derivatives to hedge commercial risk don't have to "clear" the derivative trade through a swap data repository (SDR). In addition, Dodd-Frank says a company that qualifies for the exemption doesn't have to post margin with the bank selling the derivative.

In the eyes of the business community, however, the proposed rule issued by the Commodity Futures Trading Commission (CFTC) doesn't offer a wide enough exemption. That has led to the introduction in the Senate of the Business Risk Mitigation and Price Stabilization Act, which passed the House by a vote of 370-24. Democrats and Republicans in the Senate are co-sponsoring the bill.

Yet neither the House nor the Senate bill exempts financial end-users, as the Coalition for Derivatives End-Users, the business lobbying coalition, has pressed for. That would include pension funds and commercial businesses with financial affiliates that use derivatives primarily to hedge business risks and whose derivatives use doesn't jeopardize financial stability.

A Dedicated Member

In the following note, long-time IMA® member William E. McKinley of the Pittsburgh Chapter shares his feelings about the association and membership.

Alas, this will be my final correspondence with IMA and SCMS. I renewed my membership continuously as a sign of support and to show my personal regard for having the opportunity to have served so many years from Chapter officer to National Vice President and member of the Executive Committee, followed by additional service as a Governor of SCMS. I believe it has been 38 years, and I wouldn't leave except I have inoperable and incurable lung cancer. With this note, I let current members know my pride of being a long-term member and any Classmates still wondering about my final tour of duty in this life.

—William E. McKinley



The Value of CMA Certification

The November 2011 article, "What's Your CMA Worth?" was a very interesting read on an interesting topic. Still, I feel the urge to comment on the analysis used. To me, the calculation took away the seriousness of the article and made it more marketing materials than proper financial analysis.

The reason I am saying this is that the authors basically say that the value of the CMA® is the difference in net present value of all working years with the CMA vs. not having the CMA. This is absolutely fine with me. However, they continue the analysis by expressing this value in relation to the "300 hours that one needs to invest to get it." Here is where my problem starts. In addition to the 300 hours, one must actually invest 30 additional hours each year. Instead of expressing it by saying the value per invested hour is, for example, \$613,692/300 (or \$2,045/hour), one should actually use the total hours invested to maintain the CMA (and hence the salary difference) at 1,620 hours (44*30+300), not 300. This would then be \$379/hour, significantly less per invested hour compared to what the results show.

In addition, to make the analysis really proper, one should also subtract the cost of holding this CMA every year, i.e., the annual maintenance fee plus the amount invested to achieve the required 30 hours of CPE (as these qualified programs cost money). For a back of the envelope calculation, let's assume the annual dues + CPE courses are at least \$250 a year, which ignores the money invested to take the initial exam. Having to "invest" this every year should clearly be included in the calculation as well—both the monetary investment as well as the time investment.

Given that we, as CMAs, should be able to deal properly with the "real" numbers and take that extra step to get the real cost/benefit on the table, I believe this article has missed some key steps in the analysis and thus reads more like a marketing brochure to lure additional people into the program. The proper analysis would still show the great value of the CMA degree and would accomplish the same, although proba-

bly yielding more respect as well.

Just my two cents. Apologies if it comes across a bit harsh, but I feel strongly about using proper analysis and that *Strategic Finance* should give the proper example to the CMA community.

—Jeroen Bos, CMA, CFA

Authors' Reply

We understand Mr. Bos's concerns with some of the methodologies employed in our article. While he is the only reader that has voiced his concern, we realize that other readers may have the same issues. Mr. Bos raised three issues with our methodology: (1) failing to include the annual cost (\$250) of renewing the CMA, (2) failing to include the annual cost of CPE, and (3) not including the annual number of CPE hours in our time investment analysis.

On the first issue, Mr. Bos is correct. We did not include the annual CMA fee of \$250. Including it in the analysis, however, has an insignificant effect on our results and no effect on our conclusions. To illustrate, we subjected the \$250 annual cost to the same PV analysis we applied to the annual benefit of obtaining CMA certification. Calculating the PV of an ordinary annuity of \$250 over 40 years at 5% yielded an insignificant cost of \$5,146 ($\250×20.58448). This is less than 1% of the PV of the benefits derived ($\$5,146/\$613,000 = 0.008$).

On the second issue, we considered including the dollars invested by CMAs in obtaining their required CPE each year. We decided not to include them because it was our assumption that most companies would pay for CPE for their employees; thus we believed it wasn't relevant to our analysis. We gathered anecdotal evidence from several contacts from companies such as Sonoco and Milliken who not only stated that their companies pay for CPE and let them complete these hours on company time, but also that their company also paid their annual certification fees (which suggests that issue 1 is irrelevant for many). In our further search for empirical evidence, we only found a single study quoted in *Strategic Finance* (November 2006, pp. 8-10). In it, Robert Half surveyed 1,400 CFOs regarding CPE reimbursement. The results showed that 29% reimburse it fully, 17% reimburse it partially, and 50% did not reimburse anything.

Aside from our assumption that in 2012 most companies pay for CPE, the issue becomes even more irrelevant when CMAs

consider the ample opportunities to obtain CPE for free. This was verified by John Brausch, former IMA Chair. Although we feel the cost of CPE is no longer relevant to the analysis, we will heed Mr. Bos's recommendation and include it in any future analyses. Yet even with a CPE cost of as much as an additional \$250 per year, it still would only be less than 1% of the \$613,000+ benefit derived from CMA certification. Assuming this yearly cost of CPE is added to the cost of the certification's yearly maintenance fee, the total cost is still only 1.6% of the total benefit derived. It still has no significant effect on the reliability of our results and has no effect on the validity of our conclusions.

The last remaining issue is whether we should have included the 30 hours of CPE in the cost of the time investment in maintaining the CMA certificate. Let's give Mr. Bos's argument the benefit of the doubt and make the assumption that all CPE hours have to be completed on personal time. To make the argument that these hours should be included in our calculation, one has to make the implicit assumption that, from the time they graduate college up to their retirement, all non-CMA accountants still employed in accounting have never and will never spend a single hour on further education. Looking at the required 30 hours of CPE in a different way, 30 hours per year is the equivalent to approximately 36 minutes per week. Are we to assume that even non-CMAs aren't spending approximately seven minutes a day in additional education? It would be difficult for us to understand how a non-CMA could stay employed without doing so. This supposition is supported further by the simple fact that, according to sources at *Strategic Finance*, 60% of the magazine's readers aren't certified. It would be difficult for us to assume that any professional could retain his or her job without some additional education outside of the workplace. However, since we still strongly believe that most CMAs are allowed time for CPE during working hours, this also becomes an irrelevant point.

We agree with most of Mr. Bos's suggestions and, for the sake of completeness and conservatism, will incorporate the annual CMA fee and the cost of CPE. But these inclusions have no significant affect on our results and our conclusions—all non-certified accountants, if they are rational economic beings, should seek the CMA certification. We stand by our analysis.

—Greg Krippel and Sheila Mitchell, CPA