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By Stephen Barlas, Dallon Christensen, Nanda Senathi

GOVERNMENT

U.S. Chamber of Commerce Says IESBA Ethics Code Revisions Violate Dodd-Frank

The U.S. Chamber of Commerce sent a letter to the International Ethics Standards Board for Accountants (IESBA) that opposed elements of the IESBA's exposure draft, *Responding to a Suspected Illegal Act*, published August 22, 2012. The exposure draft contains revisions to the IESBA Code of Ethics and addresses the circumstances where a professional accountant in public practice or business should override considerations of confidentiality and disclose a suspected illegal act to an appropriate external authority.

The Chamber's issue is with the phrase "external authority" and its application in the case of accountant whistleblowers. The letter, signed by Tom Quaadman, vice president of the Chamber's Center for Capital Markets Competitiveness, argues that the new Code language mandates whistleblowing for auditors and other professional accountants, which runs counter to the Dodd-Frank Act. The nature of the conflict isn't explained in the letter, however, and Quaadman didn't respond to an e-mail requesting clarification.

The letter came just a few weeks prior to Mary Jo White's nomination as head of the Securities & Exchange Commission (SEC). White was expected to be questioned during confirmation hearings about her position on the SEC's whistleblower rules enacted in May 2011. Dictated by the Dodd-Frank Act, the rules laid out the steps an individual must take in order to qualify for financial bonuses for blowing the whistle. White, who was then an attorney in private practice representing corporations, pushed for the SEC to require whistleblowers to first use internal compliance procedures before reporting to the SEC. The business community took the same position. The SEC's final ruling rejected a "go internally first" *requirement* but instead added some incentives that it hoped would induce whistleblowers to take their complaints internally first.

A year after that final ruling, the IESBA published its exposure draft, reigniting the debate about whether or not auditors ought to use internal compliance procedures first. The draft, which would have more of a symbolic importance in the realm of auditor responsibility and financial reporting, adds two new sections to the existing Code of Conduct: (1) description of the circumstances where a professional accountant can override confidentiality and (2) disclosure of a suspected illegal act to an appropriate external authority.

Jörgen Holmquist, chair of the IESBA, says going to an external authority should be a last resort and happen only if two conditions are met: (1) internal disclosure with no results and (2) disclosure is in the public interest. He adds that he doesn't believe the proposals run counter to the whistleblower provisions in the specific U.S. laws mentioned by the U.S. Chamber of Commerce.

SEC Requirements for Posting of Margins Face Opposition

Will corporate financing activities be stymied by the SEC's upcoming rule on when security-based swap dealers (SBSDs) can require posting of margins? Robert Pickel, CEO of the International Swaps and Derivatives Association, Inc., thinks so. He says imposition of an initial margin requirement "will severely curtail the use of uncleared swaps for hedging, which would disrupt key

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financial services, such as those that facilitate wider availability of home loans and corporate finance."

The SEC proposal exempts SBSDs from collecting margin from "commercial nonfinancial end users" of uncleared derivatives (for example, manufacturers and industrial companies). That's parallel to the proposed rule from the Commodity Futures Trading Commission (CFTC), whose rule on bank swap dealers handling commodity trades (such as oil or agriculture) has a section of margins written by the federal banking regulators.

The SEC, however, takes a different stance from the CFTC and the Federal Reserve where "nonfinancial end users" are concerned. These users include pension funds, endowment funds, foundations, sovereign wealth funds, family wealth vehicles, and other organizations. According to a comment from the law firm Ropes and Gray, the SEC, unlike the CFTC and Federal Reserve, doesn't allow "nonfinancial entity counterparties to negotiate appropriate margin thresholds based on individual circumstances. The Proposed Rules do not adequately identify different levels of risk among security-based swap end users."

SBSDs would have to follow prescriptive rules for assessing margins for nonfinancial end users in the case of noncleared swap transactions. That margin must cover exposure and potential future exposure (such as variation and initial margin) unless an exception applies. The SEC explains that a new rule requires SBSDs "to perform daily calculations for the account of each counterparty to a noncleared security-based swap to determine the amount of the current exposure in the account and to produce a potential future exposure measure for the account. On the next business day following the calculations, the [SBSD] would be required to collect cash, securities, or money market instruments from the counterparty in an amount at least equal to the negative equity (current exposure or variation margin) in the account plus the margin amount (potential future exposure or initial margin). Under the proposal, a counterparty would be able to meet its margin requirements by delivering cash, securities, and/or money market instruments to the security-based swap dealer. Other types of assets would not count towards meeting the margin requirement. In addition, if securities or money market instruments are delivered, only their value after applying prescribed haircuts would count towards meeting the margin requirement."

LETTERS

Fair Taxation

Thank you for the February 2013 Ethics column, "Taxing Dividends and Capital Gains Income Fairly."

I wish during the anticipated Tax Reform negotiations (or battle), Congress will seriously consider offering a *fair* playing field pertaining to the "carried interest" concept, the so-called profit participation paid to hedge fund/private equity managers, to be taxed at the marginal tax brackets instead of being taxed at a very low rate of 15%, as presently, simply because these *aren't* capital gains. They are, in reality, compensation!

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

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BOOKS

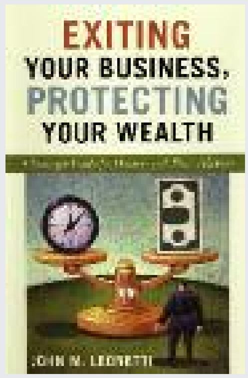
The Graceful, Successful Exit

Recent studies have shown that anywhere from 40% to 70% of business owners expect to exit their businesses in the next 10 years. Unfortunately, nine out of 10 owners don't have an exit strategy. For any business owner, financial professional, or management team member preparing for an eventual business exit, John Leonetti's *Exiting Your Business, Protecting Your Wealth* is an excellent primer.

Leonetti is an experienced exit planning strategist and former financial advisor, and his practical experience shows throughout the book. The central theme is that owners must be financially and mentally prepared to exit their businesses, and Leonetti divides business owners into four distinct types based on mental and physical readiness to exit their businesses:

- Get me out at the highest price (high mental readiness, low financial readiness),
- Stay and grow (low mental and financial readiness),
- Well off but chooses to work (high financial readiness, low mental readiness), and
- Rich and ready to go (high mental and financial readiness).

Leonetti divides the book into three sections. Part I deals with preparing for a business exit. Business wealth is usually illiquid, and business owners must take a far-reaching and long-term look at their business operations and their own personal situations. In Chapter 2, Leonetti goes into great detail about how setting clear and well-defined exit goals is a mandatory starting point for any business owner. The emphasis on defining what would make a successful exit is a must-read for any business owner or executive-team member.



Part II discusses the exit options for a business owner: selling the business, private equity recapitalization, employee stock ownership plan, management buyout, or gifting. Leonetti explains these concepts in enough detail to provide a solid understanding of the concepts, and he uses clear language and terms that won't overwhelm the reader. He continually relates the exit options to the owner's mental and financial readiness to exit the business. He also uses a central case study to present the various exit options and show how they will impact the owner's cash flow, liquidity, business ownership, and ability to continue working in the business.

Part III discusses a variety of legal, financial, and advisory matters associated with a business exit. Chapter 12 focuses on the various estate and gift tax issues associated with business exits, while Chapters 13 and 14 discuss various legal documents associated with a business exit and the importance of using a team of advisors with different specialties to facilitate the entire exit process.

Throughout the book, Leonetti does an excellent job of stressing the importance of preparation and a long-term focus on business exits. He emphasizes that an owner's mental readiness is as important as the quantitative decision criteria. For owners who have spent years building a successful business, the topic of how to exit is a difficult, often sensitive area. As someone who has successfully started and exited businesses in the past, Leonetti uses his personal experience to illustrate the concepts.

This is an excellent book for all business owners, management teams, and advisors to read. No business owner wants to consider an eventual exit from the business, but it will happen. Leonetti provides real-world examples, well-rounded analysis of legal and tax issues, and a variety of checklists and documentation for an owner to begin the thought process of a business exit. Even new business owners can take the concepts in this book to gain a greater perspective on how they can build their businesses to facilitate a successful exit based on the their initiative and readiness.

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