SF bulletin

By Stephen Barlas, Christopher Dowsett, Ashutosh Srivastava

GOVERNMENT

House Bill Would Tie the PCAOB's Hands on Auditor Rotation

By Stephen Barlas

House Republicans are pushing a couple new bills that would benefit corporate financial executives. The first would tie the hands of the Public Company Accounting Oversight Board (PCAOB), which has been thinking of requiring auditor rotation. The PCAOB issued a concept release on August 16, 2011, seeking public comment on "whether mandatory auditor rotation would significantly enhance auditors' objectivity and ability and willingness to resist management pressure." The Board has given no indication of when the next step might be taken, if at all. If Republicans in the House have their way, there will be no next step. The Audit Integrity and Job Protection Act (H.R. 1564), introduced in April by Rep. Robert Hurt (R.-Va.), would prohibit the PCAOB from requiring that the audits of a particular issuer be conducted by specific auditors or that such audits be conducted by different auditors on a rotating basis. The Hurt bill was passed unanimously by the House Financial Services Committee on June 19, 2013.

Business groups strongly support the Hurt bill. "Mandatory audit firm rotation would reduce the supervision and oversight of the audit committee and management, rolling back strong corporate governance policies," says Tom Quaadman, vice president of the Center for Capital Markets Competitiveness (CCMC) at the U.S. Chamber of Commerce. "Indeed, we must question why the government, or a quasi-government entity, should mandate which vendor a business should use."

Robert Smith, corporate secretary, vice president, and deputy general counsel of NiSource Inc., who represented the Society of Corporate Secretaries and Governance Professionals at the House hearings discussing the bill, says that mandatory rotation was considered for possible inclusion in the Sarbanes-Oxley Act (SOX) but was ultimately rejected. A Government Accountability Office (GAO) report also found little to recommend rotation. What SOX does require is rotation of the lead audit partner every five years and every other year for audit team members who are significantly involved. Smith argues that these existing safeguards "adequately address the concerns of professional skepticism and ongoing objectivity." And in the years since SOX passed, the Securities & Exchange Commission (SEC) has finalized rules that mandate the independence of some audit committee members.

The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) opposes the Hurt bill. That won't be enough to prevent it from being passed in the House, but it may carry more weight in the Senate. Damon Silvers, director of policy and special counsel at the AFL-CIO, says the Hurt bill "weakens the ability of the PCAOB to play its role in protecting our economy against systemic risk, and it weakens the independence of auditor regulation."

Proposed Elimination of Dodd-Frank Pay Disclosure

On June 19, the House Financial Services Committee also passed the Burdensome Data Collection Relief Act (H.R. 1135), which would repeal a section of the Dodd-Frank Act that applies to executive compensation disclosures. Section 953 of Dodd-Frank requires public companies to include disclosures *continued on page 20*

BOOKS

Empower and Engage Your Team

What are the biggest challenges faced by rapidly growing companies? Ask the CEO of any such company and chances are that establishing a growth-oriented culture, where employees are self-motivated, loyal, passionate about the company's shared goals, and perform to their fullest potential, would be at or near the top of the list.

Typically, such companies are characterized by rapidly shifting internal and external priorities, frequently changing business models, unclear directives and accountability structures, and/or the lack of alignment within the leadership team. As a natural response to such situations, employees fall into a fight, flight, or freeze mode. In her book, *Smart Tribes: How Teams Become Brilliant Together*, Christine Comaford refers to this as the "critter state." People in the critter state are driven by fear, individual safety, and survival rather than collective success. Instead of focusing on real issues that impede growth, they're emotionally disengaged, don't collaborate, and spend time and resources on solving problems that either don't exist or aren't important. When management decision making and behavior is driven by the critter state, it's nearly impossible for companies to move up to the next level of growth.

In *Smart Tribes*, Comaford, an applied neuroscience expert and a *New York Times* best-selling author, presents a recipe to move employees out of the

critter state. When in the critter state, decision making is driven by the most primitive part of the brain, which is a stimulus-response system focused on survival. Instead, employees need to be in the "smart state," where decision making is driven by the prefrontal cortex, a more evolved part of the brain that enables humans to plan, innovate, solve complex problems, and think abstract thoughts. Employees in the smart state are focused, accountable, collaborative, loyal, and imbued with a passion to solve problems. With their creativity, innovation, and passion unleashed, they not only outsmart the competition but do it consistently, again and again.

Employing well-researched neuroscience and behavioral science techniques, Comaford proposes a very structured approach to move from the critter state to the smart state. She recommends the following five accelerators that can help the transition:

Focus: Be aware of what is important and delete, defer, or ditch everything else.

Clarity: Be aware of why you do what you do.

Accountability: Make accountability a part of the company's DNA by having clear expectations, owner's agreement, and well-defined rewards and consequences.

Influence: Be able to understand, empower, and motivate people.

Sustained results: Have energy to enjoy your work and avoid burnout.

Interspersed with numerous real-life cases and examples, *Smart Tribes* is a very well-written book. Comaford follows a "do it yourself" approach, using assessment questions, resources, and action plans at the end of each section, making it a very engaging and interactive read. Another highlight is that it's backed by rigorous scientific research, making it very credible and trustworthy.

The issues Comaford raises in the book are extremely critical for success in the contemporary business environment. *Smart Tribes* is a great read for anyone managing a team in a fast-paced, dynamic environment.

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in their annual proxy statements that permit shareholders to compare the compensation of the firm's executives to its financial performance. It also requires publicly traded companies to calculate and disclose in each filing with the SEC the median annual total compensation of all of its employees excluding its chief executive officer, disclose its CEO's annual total compensation, and calculate and disclose a ratio comparing those two numbers. Companies will have to do some very specific number crunching, which will complicate the task for the SEC. Mary Jo White, SEC chairman, has said that the pay ratio was proving difficult for the staff to implement.

Charles G. Tharp, CEO of the Center On Executive Compensation, says the pay disclosure wouldn't provide "material information" to investors and is therefore inconsistent with the purpose of SEC disclosure rules. "The cost of implementing the requirement for many companies is likely to be in the millions of dollars," Tharp says, referring to a survey the Center has collected from its members. One company estimated that the total cost of calculating the pay ratio, including systems changes, would be at least $7.6 million. Another estimated that the cost of calculating just the pension component of total compensation across all payroll systems would be $2 million. "Clearly, given that few shareholders are interested in the information, the cost of generating the pay ratio does not generate sufficient benefit to justify the mandate," Tharp concludes.

The House Financial Services Committee passed H.R. 1135 by a vote of 36-21. With five Democrats in support, the bill has a semblance of bipartisan support.

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The FASB Endorses Three Private Company Council Proposals

On June 10, 2013, the Financial Accounting Standards Board (FASB) voted to endorse three proposals from the Private Company Council (PCC). The proposals describe alternatives within U.S. GAAP that involve accounting for intangible assets acquired in business combinations, goodwill, and certain types of interest rate swaps.

Under the first proposal, private companies wouldn't be required to separately recognize certain intangible assets acquired in a business combination. Private companies that elect the alternative only have to recognize those intangible assets arising from noncancelable contractual terms or those arising from other legal rights. The second proposal allows for amortization of goodwill and a simplified goodwill impairment model, enabling private companies that elect the alternative to amortize goodwill over the useful life of the primary asset acquired in a business combination, not to exceed 10 years. The third proposal contains two simpler approaches to accounting for certain types of interest rate swaps that a private company enters for the purposes of economically converting its variable-rate borrowing to a fixed-rate borrowing. Both approaches would apply to all private companies except financial institutions.

The proposed alternatives are expected to be issued for public comment. The IMA® Small Business Financial and Regulatory Affairs Committee (SBFRC) and IMA's other technical committees will continue to monitor these projects and determine whether to submit a letter of comment. The advocacy efforts of these IMA committees, including previous comment letters, can be viewed at www.imanet.org/about_ima/advocacy_activity.aspx.