SF bulletin

By Stephen Barlas, John Brausch, Dan Goldzband, Christine Murray

GOVERNMENT

Business Groups Oppose Further Regulation of Asset Managers

By Stephen Barlas

A quiet storm is brewing in the business community over the potential regulation of asset managers—including the big companies, such as The Vanguard Group, Inc., and Fidelity Investments, which provide investment options for corporate pension programs and corporate treasurers as well as individuals. The Dodd-Frank Act raised the possibility that the Financial Stability Oversight Council (FSOC), a recently created regulatory body, could prescribe "enhanced prudential standards and supervision" if it found that financial or nonfinancial companies pose "a systemic risk" to the financial system. "Asset Management and Financial Stability," a Treasury Department report published in September, suggests asset managers do pose such a risk.

Written by the Office of Financial Research (OFR), a new unit within the Treasury that provides information to the FSOC, the report argues that investors and asset managers "crowd or 'herd' into popular asset classes or securities" and thus "magnify market volatility." The OFR report then argues that stock and bond funds "face the risk of large redemption requests in a stressed market," forcing fund managers to sell portfolio securities at fire sale prices and transmitting risks across the financial system.

The report has taken a rhetorical pounding from numerous sources. Tim Buckley, managing director and chief investment officer at Vanguard, says, "While the report does make such helpful distinctions in a few instances, we believe that it suffers from several significant shortcomings, namely, incomplete and inaccurate facts, generalizations that lack empirical support, and omissions about existing regulatory safeguards that mitigate the very risks identified in the report."

The Securities & Exchange Commission (SEC) already regulates asset managers as it does money market funds (MMFs). The question is whether the FSOC will push the SEC to further regulate asset management companies as it has done with MMFs. Alice Joe, executive director of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness, says, "Any increase in cost or decrease in efficiency in how these funds work will impact U.S. investors—both companies and their employees—directly and significantly. Additionally, lost efficiencies and higher costs are actually compounded over time because of the long-term nature of retirement accounts."

Proposed Crowdfunding Rules Include Disclosure Requirements

Start-ups and small companies that want to raise capital through crowdfunding will have to make extensive disclosures to the SEC, which issued a proposed rule on crowdfunding in October 2013 and is now accepting comments prior to issuing a final rule. Crowdfunding is a method for start-ups and small businesses to raise money, in relatively small contributions, without having to issue stock. The Jumpstart Our Business Startups Act (JOBS Act), enacted April 5, 2012, authorized the SEC to allow crowdfunding.

The SEC's proposed disclosure requirements are subject to revision based on comments, but here is the initial list:

- The name, legal status, physical address, and website address of the issuer;
- The names of the directors and officers (and any persons occupying a similar status or performing a similar function) and each person holding more than 20% of the shares of the issuer;
- A description of the business of the issuer and the

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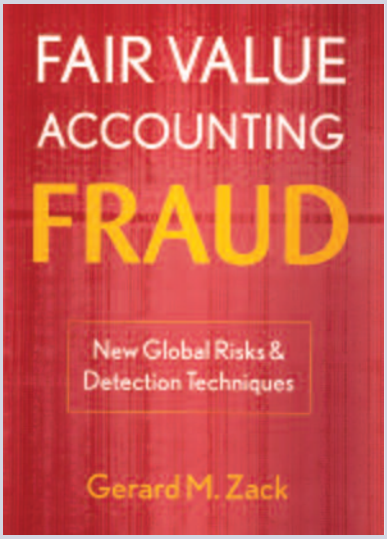
BOOKS

Fraud Risks and Detection

Fair Value Accounting Fraud: New Global Risks and Detection Techniques by Gerard M. Zack is two books in one. The first is a summation on fair value accounting, and the second is a map for preventing fraud as accountants are asked to be more creative in determining fair market values of assets and liabilities.

Zack's primary purpose of writing this book is to expose fraud in fair value accounting while laying a carefully constructed foundation as to how we've become so reliant on fair value measures. In 2008, the Securities & Exchange Commission (SEC) encouraged the expansion of the use of fair value accounting in financial statements. That same year, Congress encouraged the SEC to study the fair value provisions of the 2006 Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measures*. In 2007, it was followed by SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, and other fair value measurements came into play as the Financial Accounting Standards Board (FASB) worked to converge U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

Zack delivers a primer on determining fair value before taking the reader on a tour through the financial statements. Along the way he points out the impact of recent accounting pronouncements on financial statements. Zack divided the book into 23 chapters—16 of which are



dedicated to asset-based and liability-based schemes, including chapters on intangible assets and goodwill, business combinations, debt obligations, guarantees, and contingencies and provisions.

In each of these chapters, Zack points out fraud risks unique to the topic, which are set aside in gray, numbered boxes. He proves beyond a reasonable doubt that determining fair value brings special risk to each section of the balance sheet and that the reader would do well to be aware of them. I found it very helpful that Zack used this method of easy-to-reference fraud risks. In the chapter on contingencies and provisions, he offers the following fraud risks:

1. Failure to recognize a liability (or to impair an asset) when the criteria for recognizing a loss contingency have been met,
2. Omission of note disclosures regarding an unrecognized loss contingency that has a likelihood of occurrence that's more than remote,
3. Recognition of an asset for a gain contingency prior to its meeting the criteria for recognition,
4. Underestimating a recognized liability for a loss contingency,
5. Using inappropriate present value techniques to understate a contingent liability, and
6. Inflating the fair value estimate of a recognized gain contingency.

Zack then devotes chapters to fair value issues for nonprofits and fair value disclosure issues before ending with sections about the "Detection of Fair Value Accounting Fraud," including guidance on the subject from the SEC and the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

This is an important book and a must-read for accountants and anyone else relying on financial statements. As accountants, we should understand that fair value measurement relies on good judgment and creativity. But creativity coupled with internal and external financial pressures could lead to fraud. This book will help ensure you understand fair value accounting rules and recognize the possible pitfalls of fair value measurement.

—John Brausch, president of
J Brausch and Co and former IMA Chair,
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anticipated business plan of the issuer;
- A description of the financial condition of the issuer;
- A description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;
- The target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount;
- The price to the public of the securities or the method for determining the price; and
- A description of the ownership and capital structure of the issuer.

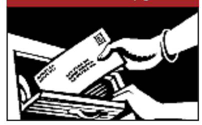
A company won't be able to raise more than $1 million in a 12-month period, and individual investors will be limited as to how much they can contribute. Under the proposed rule, if an investor's annual income *and* net worth are both less than $100,000, then an investment limit of $2,000 or 5% of annual income or net worth (whichever is greater) would apply. If either annual income or net worth exceeds $100,000, then a limit of 10% of annual income or net worth (whichever is greater) becomes that person's total investment cap, and it can't exceed $100,000.

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.

LETTERS



Addressing Social Networking

I want to comment on the Ethics article in the December 2013 issue: "Social Networking at Work Is a Major Risk with Large Costs." That was a good article with good statistics and reasoning.

I fully agree with the statement that "employers are paying considerable sums for ostensible work time spent on personal matters," and that is a problem. And I do not mean to justify the significant amounts of employee time inappropriately spent on nonwork matters when I cite the other side of the coin—BUT—employers started demanding that employees spend a considerable amount of their ostensible nonwork time on company matters long before the advent of Facebook or LinkedIn. And while it is clearly unethical to use any more than an immaterial amount of company time on personal matters, whether on- or off-line, it is EQUALLY UNETHICAL for companies to impose on employees the kind of performance and response expectations that cannot help but blur and erase the boundary between personal and work hours. It is the companies that blurred this line with their excessive demands, not the employees.

Turnabout is not fair play, but it is an excellent explanation. If companies want a credible stance from which to address excessive social networking on company time, they will need to quit tying employees to their company smartphones and e-mails 24-7, i.e., to stop placing excessive demands on employees' personal time.

—Dan Goldzband, CMA

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

From left to right: Warren Allen, IFAC president; Jeff Thomson, IMA president and CEO; and Fayez Choudhury, IFAC CEO.

IMA Named Member of IFAC

By Christine Murray

On November 14, 2013, IMA® was named a member of the International Federation of Accountants (IFAC). The announcement was made during an IFAC council meeting in Seoul, South Korea.

IMA was granted IFAC membership following a thorough review of its governance and internal operating structures, which included an analysis of IMA's *Statement of Ethical Professional Practice*, the CMA® certification program, and IMA's continuing professional education requirements (CPE).

Along with IMA, three existing associate organizations were admitted as members, five new associates were admitted, and the Association of Corporate Treasurers became an IFAC affiliate. IFAC is composed of 179 members and associates in 130 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce.

"We are delighted to include these organizations," said IFAC CEO Fayez Choudhury. "IFAC has many synergies with the Institute of Management Accountants and Association of Corporate Treasurers, particularly in light of our focus on the important role played by professional accountants in business in the global economy."

As a member of IFAC, IMA will contribute to the organization's mission of strengthening the accounting profession through global initiatives, including IFAC's Professional Accountants in Business (PAIB) Committee. IMA will also offer technical guidance on international accountancy programs and standards issued by independent standards-setting boards supported by IFAC and the International Accounting Standards Board (IASB).

IMA President and CEO Jeff Thomson, who attended the IFAC meeting, said, "Throughout its 94-year history, IMA has set extremely high standards for management accounting certification, continuing education, and ethical business practices for its members and the profession as a whole. We look forward to working with IFAC to address significant challenges facing the profession globally, including financial reporting standards, the talent shortage, and the needs of emerging economies."

IFAC members are required to support IFAC's mission and programs, demonstrate compliance with the Statements of Membership Obligations, be financially and operationally viable and have an appropriate governance structure, make financial contributions, and meet the other criteria described in the Membership Application Process, the IFAC Constitution, and the IFAC Bylaws.