SF bulletin

By Amanda Balbi, Stephen Barlas, Ryan Leist, Letitia Meier Pleis

GOVERNMENT

KPMG Fined for Auditor Independence Violations

By Stephen Barlas

The Securities & Exchange Commission (SEC) imposed a significant penalty on KPMG for violating auditor independence rules. The SEC assessed KPMG $8.2 million for providing nonaudit restructuring, corporate finance, bookkeeping, and payroll services to three audit clients, which the Commission didn't name. In a separate instance, KPMG hired an individual who had recently retired from a senior position at an affiliate of an audit client and then loaned him back to that affiliate to do the same work he had done as an employee. This resulted in the professional acting as a manager, employee, and advocate for the audit client. These services are prohibited by Rule 2-01 of Regulation S-X of the Securities Exchange Act of 1934.

The SEC didn't name the companies that received the services or disclose whether the services had been solicited by the clients. *Bloomberg News* identified one of the companies as General Electric in its article "Is the SEC Going Easy on General Electric?" Paul A. Beswick, the SEC's chief accountant, didn't reply to an e-mail asking whether the clients had contributed to the independence violations or why the SEC wasn't censuring KPMG for providing tax services, which was the subject of a separate Commission report.

In that separate report discussing the potential violation of providing tax services, the SEC was a bit unclear about why it wasn't penalizing KPMG for overstepping the independence laws. Auditors are allowed to provide tax services as long as the audit staff doesn't become a *de facto* employee of the client. In other words, services can be provided, but personnel can't be loaned.

On the one hand, the SEC pointed out the KPMG "loaners" were supervised by, took sole direction from, and had their performance evaluated by the audit clients' managers. That should be a violation. On the other hand, the KPMG loaners were nonmanager-level KPMG professionals performing junior-level tasks related to tax compliance, such as data inputting—in other words, they weren't doing anything significant—so that may have been a mitigating factor. But the SEC doesn't address why the tax services KPMG provided were acceptable under independence rules.

Without admitting or denying the findings, KPMG agreed to pay $5.3 million in disgorgement of fees received from the three clients plus prejudgment interest of $1.2 million. KPMG additionally agreed to pay a penalty of $1.8 million and implement internal changes to educate firm personnel and monitor the firm's compliance with auditor independence requirements for nonaudit services. KPMG will engage an independent consultant to evaluate such changes.

KPMG issued a statement that said, in part, "In the years since the events discussed in this SEC action, KPMG has implemented internal changes that are designed to ensure its ability to comply with restrictions on providing nonaudit services to SEC audit clients and/or their affiliates."

Business Groups Complain about Proposed Liquidity Ratio

Financial industry regulators in the United States have proposed implementing a liquidity coverage ratio on large banks, insurance companies, and nonbank affiliates of corporations with the intention of preventing the kinds of shocks that affected the economy at the start of the 2009 recession. The move comes as U.S. banks have expanded corporate lending and loosened lending criteria, according to a report issued in January by the Office

continued on page 24

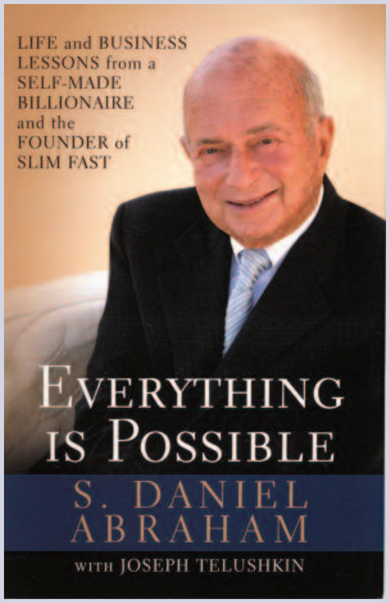
BOOKS

Lessons of Business

At a time when it seems that only those willing to play dirty in business make it big, *Everything Is Possible* is a book that rekindles the hopes of success for the small businessman. Slim-Fast founder S. Daniel Abraham tells the story of how he started from modest means to become a self-made billionaire. Abraham tells his story through lessons he's learned from his early childhood and years in the Army to his first business purchase of a medical center for $5,000 and the ultimate sale of Slim-Fast for $2.3 billion. Abraham centers his story around 16 life lessons that helped him have a successful business career.

One of the biggest lessons Abraham learned is, "Never, Never, Never Give Up." Abraham learned this lesson when his daughter was born with a serious heart problem. It took persistence and hard work, but he finally found a doctor who could successfully perform the needed procedure.

Another important lesson is, "There is no such thing as a mistake." Abraham states that calling something a mistake suggests that you shouldn't have ever taken the action, but "any time you make a decision, whether in football, business, government policy, or personal life, as long as you make it on the basis of information you have at the time, you shouldn't be faulted, and you shouldn't fault yourself if things don't work out as expected." It's unfair to judge a past decision based on information that's



"There are times when making a decision on the basis of instinct alone is the only reasonable thing to do."

only now available. If you live in fear of regret, then you'll never go forward.

The philosophy of continuous improvement reminds us that even if it isn't broken, you can still make it better. Many times the thought is that if it isn't broken, then there's no need to fix it. In reality, not working to make it better will mean a competitor will come out with something better. This even applies to personal skills—if you don't continuously practice even after making it to the top, someone will notice.

Abraham also discusses decision making. One lesson is: "There are times when making a decision on the basis of instinct alone is the only reasonable thing to do." When Abraham would conduct consumer research, he would ask people in a control group which packaging they liked better. One package would be red, and one would be blue—the only thing differentiating them. Even though the people didn't realize that was the only difference, they would pick one over the other even though they couldn't justify their choice. Because their choices were based on instinctive preference alone, Abraham would never get the true answer. When this happens, instinct has to be the deciding factor. Abraham argues that you should trust it and not try to justify it.

Abraham doesn't only write about business. He also writes about giving and supporting what you believe in. Abraham discusses his beliefs on the pleasure of giving, what he has learned from Judaism, and how it's necessary to fight hard when you believe you're right, even if that means going up against powerful organizations (such as the Food and Drug Administration) like he did. Overall, the stories that Abraham tells about his life are interesting and captivating. It's a history that all readers can learn from.

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continued from page 22

of the Comptroller of the Currency (OCC).

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) and some other business groups believe banks will pull back on commercial corporate lending if the proposed rule becomes final. The CCMC is "concerned that the proposed liquidity coverage ratio proposal will create significant disincentives for financial institutions to offer certain products and restrain the amount and type of capital available to businesses," says Tom Quaadman, vice president of the CCMC.

The proposed rule issued by the OCC, Federal Reserve, and Federal Deposit Insurance Corporation aims to imitate the quantitative liquidity standard specified by the Basel Committee on Banking Supervision (BCBS)—Basel III LCR. Starting in 2015, it would require active banking organizations to hold sufficient high quality liquid assets (HQLA) to meet their obligations and other liquidity needs that are forecasted to occur during a 30-calendar-day stress scenario. The proposed U.S. version would require a covered company to maintain an amount of HQLA that would be the numerator in a ratio that's no less than 100% of its total net cash outflows over a prospective 30-calendar-day period (the denominator of the ratio).

The U.S. agencies are proposing to establish a minimum liquidity coverage ratio that would be consistent with the Basel III LCR but with some modifications. For instance, the proposed rule includes transition periods similar to, but shorter than, those set forth in the Basel III LCR.

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.

NEWS

Survey Finds Students Need Work Experience

By Amanda Balbi

Getting good grades is no longer enough to help accounting and finance graduates land their first job, according to a survey conducted by Accountemps. Out of the more than 2,100 CFOs polled, 83% said it's important for entry-level accounting and finance professionals to have gained work experience during college—40% thought it was very important and 43% thought it was somewhat important.

Max Messmer, chairman of Accountemps, says that "Professional work experience has become increasingly critical for entry-level applicants in a competitive hiring environment." Accountemps offers a few suggestions for how students can gain the work experience they need:

1. Find an internship or a mentor program. Not only will you be able to learn from a mentor, but you will also make connections. A part-time internship might one day turn into a full-time position.

2. Don't limit yourself to only paid internships. Unpaid internships can be just as beneficial and allow you to network with the professionals in your field. They'll get to know you and your work.

3. Volunteer your time to your community or local organization. Getting involved in your community will show you're able to work with people.

4. Think of yourself as a professional. Whether you work part time or as an unpaid intern, walk into the workplace with the mind-set of a full-time employee. Learn office etiquette from your coworkers.

5. Continue networking even after your internship. Keep in touch with the contacts you make because it will help them keep you in mind once a position becomes available.

For more information on the study, visit http://accountemps.rhi.mediaroom.com.

BOOKS

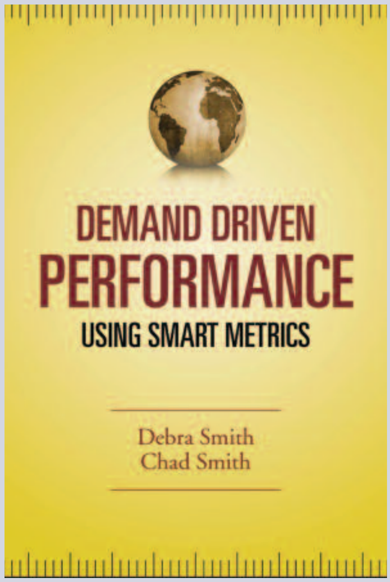
Improving Flow for Greater ROI

A "deep truth" we're taught in business is that decreasing unit cost will increase return on investment (ROI). Many organizations rely on enterprise resource planning (ERP) systems to collect and analyze cost data. Yet these systems were developed based on the business environment and reporting requirements in the 1960s. While there have been many technological advances since then, managers still make decisions based on these outdated systems. In *Demand Driven Performance: Using Smart Metrics*, Debra Smith and Chad Smith challenge the unit-cost assumption and provide an updated guide to management accounting and assessing metrics.

The focus of smart metrics is to understand manufacturing as a process and to know the first law of manufacturing, which is that all benefits (revenue, inventory, expenses) are directly related to the speed of flow and materials. The key principles involved with flow include:

1. Time is the ultimate constraint,
2. The system must be well-defined and understood, and
3. Linkages or connections between points in the system must be smooth.

The authors connect the rate of flow of materials and information directly to ROI. The focus is to understand the interdependencies and have them act in concert together, not against each other. Performance standards should be viewed in relation to time and cash



flow, not to unit cost. Once a manager has embraced flow, he or she should use it to drive reporting, measures, tactical planning, and execution for all operations. This should help synchronize demand and supply signals between critical points in flow and prioritize improvement efforts based on identifying and then removing, whatever blocks flow. Actions should then be quantified by the net change in the revenue and cost to understand the impact on ROI.

As an example, the authors include an examination of the production issues with the Boeing 787 Dreamliner. That dilemma contains three lessons every company should learn: (1) Don't create unnecessary supply chain complexity—Boeing added to its supply chain by increasing, not only outsourcing, content (30% of content for the 787 compared to 5% for the 747) and created a level of supply chain complexity difficult to control, let alone synchronize and manage. (2) Industries with program accounting should beware—Boeing is speculated to have spent between \$12 billion and \$18 billion, much greater than the original \$6 billion estimated by Boeing management when they shared their supply chain methodology with Wall Street. (3) Understand and value your organization's human capital—Boeing's management deemphasized in-house engineering and relied on industry partners for the 787, causing issues in design and production while creating tension with the union.

Demand Driven Performance is a must-read for anyone involved in the manufacturing process, managers, and students who want a great supplement for their managerial accounting courses. It provides historical perspectives on flow, cost, and issues in management accounting. The charts and visual aids assist in understanding the impact of flow on ROI and give instructions on how to design and implement a demand driven information system. The authors give too many great examples and too much information to be able to share it all, so get yourself a copy and become the expert for your organization.

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