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By Amanda Balbi, Stephen Barlas, Ryan Leist

GOVERNMENT

SEC Looking More Closely at Internal Controls

By Stephen Barlas

The Securities & Exchange Commission (SEC) is pressuring companies to comply with the 2013 updated *Internal Control—Integrated Framework* from the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Released in May 2013, the updated version replaced the 1992 version, which had been considered out-of-date for a while, certainly since passage of the Sarbanes-Oxley Act of 2002 (SOX).

Section 404 of SOX requires management at public companies to select an internal control framework and then assess and report annually on the design and operating effectiveness of their internal controls. The majority of U.S. publicly traded companies have adopted COSO's 1992 Framework to do this. Because companies were able to use the 1992 Framework until December 31, 2014, the SEC wasn't raising any red flags when conducting its compliance checks of corporate financial statements. As far as the SEC was concerned, using the 1992 version was acceptable, if not optimal. Now that's changing, according to numerous SEC officials who spoke at the 2014 AICPA (American Institute of Certified Public Accountants) National Conference on Current SEC and PCAOB (Public Company Accounting Oversight Board) Developments in December.

The SEC's pressure on companies to use the 2013 version is partly because the Commission appears to be concerned about somewhat disquieting levels of internal control weakness. In a recent speech, Brian T. Croteau, deputy chief accountant in the Office of the Chief Accountant (OCA), warned companies that, based on investigations in 2014, he continues "to question whether material weaknesses are being properly identified, evaluated, and disclosed."

The OCA, Division of Corporation Finance, and Division of Enforcement are paying more attention than ever to internal control over financial reporting (ICFR) in an "ongoing, coordinated, and increasingly integrated" fashion in the context of "routine consultation, disclosure review, and enforcement efforts." Kevin M. Stout, senior associate chief accountant in the OCA, explains, "I am hopeful that the improved organization and structure of COSO 2013 vs. the 1992 version, through the use of principles and points of focus, leads to improved evaluations of the components outside of control activities."

Convergence Out the Window?

James Schnurr made his first public appearance as the SEC chief accountant at the 2014 AICPA National Conference in December. He had some very interesting things to say, particularly about convergence between International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP). He indicated he was leaning toward a recommendation to SEC Chairman Mary Jo White that the SEC drop its long-gestating effort to converge U.S. GAAP with IFRS. And with regard to a step toward convergence, besides the one that has already been made, he seemed to say that the converged revenue recognition standard, which goes into effect in 2017, has created some confusion among company accounting staffs.

White asked Schnurr to take "a hard look" at overall convergence when he came aboard in September 2014.

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He plans to make a recommendation to her in the near future as to the path forward. “Based on what we have heard to date, it appears that U.S. constituents generally are not supportive of full adoption for a variety of reasons, including legal issues and general cost-benefit concerns, among others. Those concerns will certainly be considered in my analysis,” he said.

On revenue recognition, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) are meeting to iron out unintended compliance challenges. “We understand from speaking to various parties that there are a variety of accounting questions that range from questions that may require additional action by the standard setters to questions that appear to be more educational and simply need clarification as to what the intentions of the boards were when drafting the standard,” Schnurr explained. Some of those could have “a significant and widespread impact,” he added. For example, unresolved questions regarding the identification of performance obligations and the accounting for licenses are placing some stress on being able to implement the standard by its current effective date.

Robert Half Workplace Innovation Survey

By Amanda Balbi

A recent survey of more than 2,100 CFOs in the United States reveals innovation is present in the workplace but can use a boost. Published by Robert Half Management Resources, the survey found that 59% of CFOs report their workforce is “somewhat innovative” but can use improvement, while only 31% report a “very innovative” workforce.

Paul McDonald, senior executive director for Robert Half, said, “Organizations need to embed innovation in their hiring criteria and corporate culture.” And CFOs use a number of strategies to promote innovation among their teams: 77% provide additional training, 62% provide interdepartmental cross-training, and 54% offer rewards for successful new ideas. Other ways include brainstorming sessions and hiring consultants for a new perspective.

To read more about the survey, visit http://rhmr.mediaroom.com/2015-01-08-These-Cities-Have-The-Most-Innovative-Workers.

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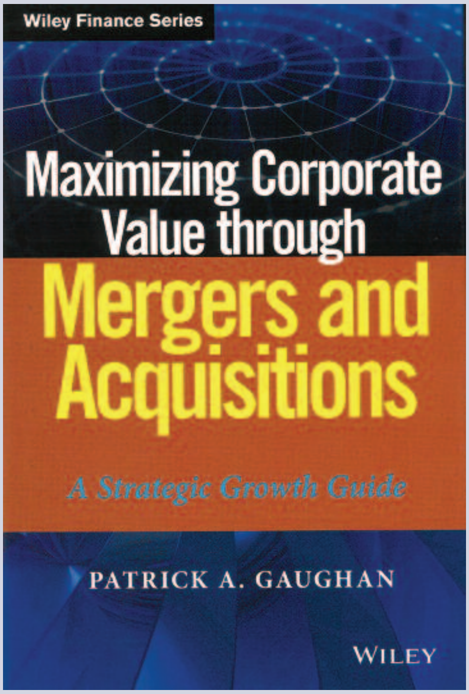
BOOKS

Using M&A in Your Company



A major reason companies use M&A is to diversify their product base beyond their industry in an attempt to enter new markets.

Why do some mergers succeed and others fail? In *Maximizing Corporate Value through Mergers and Acquisitions: A Strategic Growth Guide*, Patrick Gaughan examines a large body of research to find the best ways to maximize shareholder wealth using mergers and acquisitions (M&A). Prior to doing deals, management needs to be aware of the strategy, diversification, integration, and valuation effects of M&A and how they are different for bidders and targets. Gaughan takes a systematic approach when examining the risks and benefits associated with different kinds of deals.

A major reason companies use M&A is to diversify their product base beyond their industry in an attempt to enter new markets. Gaughan provides examples and studies from the 1980s and 1990s that show this strategy for M&A is questionable at best. Increased corporate focus on specialization was consistent with shareholder wealth maximization, not diversification.

He found that three types of acquisitions caused lower and usually negative returns in M&A:

1. Diversifying M&A—If a company is going to diversify, evidence shows that related acquisitions within an industry are significantly better than unrelated acquisitions.

2. Acquiring a rapidly growing company—The negative impact of acquiring a rapidly growing company reflects the difficulty in buying growth and the reality that most companies are forced to overpay for growth projections.

3. Acquiring a company when existing management has a poor performance record prior to the deals—If an executive performs poorly at running an existing business, increasing managerial demands with M&A will result in more of the same, or worse, performance.

Gaughan is critical of executives' motivations in M&A. Larger companies have higher revenues, assets, and costs. Part of the costs is management compensation—specifically CEO compensation. Therefore, a way for CEOs to make more money is to run larger companies. One study Gaughan examined found that for every 1% increase in company size, CEO compensation increased by one third of 1%. Thus it's important for boards to ensure that CEOs are pursuing M&A programs for shareholders' benefit, not just for personal gain.

M&A often appear to offer high returns, but there are also high risks that are hidden. Managers should understand the available growth options as well as the probabilities of success given the industry environment.

The book is filled with research, and Gaughan breaks down the types of deals that are successful and those that typically fail by evaluating key factors such as market, industry, and psychological considerations. This is a great handbook for anyone involved in the M&A process and a must read for any board member, executive, or advisor considering M&A in his or her company.

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