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Standard vs. Practices

The move to principles-based accounting raises concerns; paid sick time may become mandatory; the DoJ looks at private-equity "clubs"; Six Sigma gets bad press; a medical-records database alarms privacy experts; and more.

CFO Staff, CFO Magazine
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Even before President Bush told an enthusiastic Wall Street audience in January that "we don't need to change the [Sarbanes-Oxley] law, we need to change the way the law is implemented," the Public Company Accounting Oversight Board (PCAOB) was taking steps to do precisely that. But as it advances an openly "principles-based" approach in replacing Auditing Standard No. 2 with Auditing Standard No. 5, some question whether the new standard is doomed to fail unless associated laws and practices also change.

In an effort to make the auditing of internal controls more efficient, the new AS #5 would no longer require auditors to offer an opinion on management's evaluation of internal controls. It would instruct auditors to cover the areas of greatest risk, rather than obliging them to visit the majority of operations, and also permit them to rely on previous audits rather than start from scratch each year.

While the new rule is subject to revision (following a comment period that ended February 26) and approval from the Securities and Exchange Commission, it looks likely to pass. SEC officials have applauded the changes and note that the Commission's own guidance on the topic takes a similarly principles-based approach.

But critics say the revision will have little impact given the potential for investors to sue auditors and companies. "You can't just go out and change from rules to principles without changing the environment as well," contends Dennis Stevens, director of internal audit for Alamo Group. Unless changes in the legal environment occur — caps on the damages that audit firms might face, for example — Stevens says that "AS #5 is not going to work."

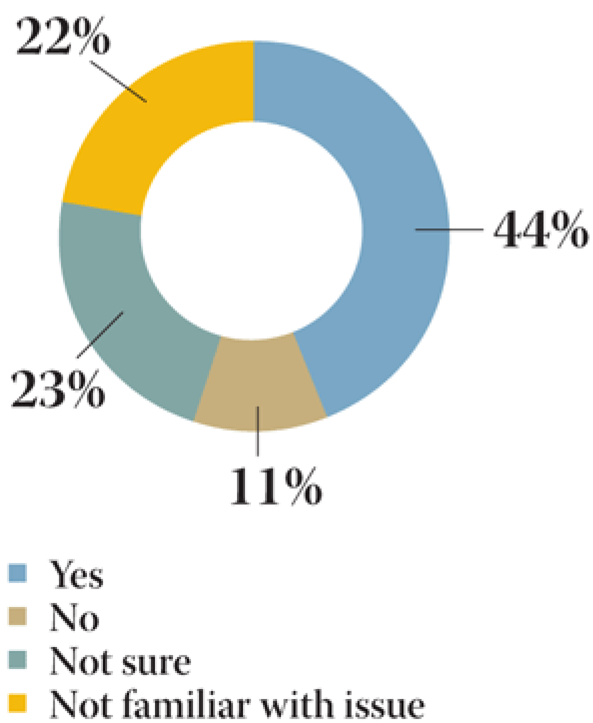
Auditors expect change to be slow. Susan Lister, national director of audit policy at BDO Seidman, says AS #5 is "a step in the right direction," but will take time to implement. With "hundreds of engagement teams, it's difficult to ensure that people are making appropriate judgments when most are inexperienced," she says. "And then you have inspectors coming in, and their judgments will undoubtedly be different than ours." For now, at least, the firm is likely to keep rules-based policies in place for protection.

These difficulties, though, seem unlikely to derail the move to principles-based accounting. Zoe-Vonna Palmrose, SEC deputy chief accountant for auditing and professional practice issues, says that the approach, as part of a broader effort to combat accounting complexity, "is at the top of [SEC] chief accountant Conrad Hewitt's agenda."

The SEC may form a working group comprising managers, auditors, and regulators that would explore the broader changes needed to make principles-based accounting more viable. — *Alix Stuart*

PRINCIPLE UNCERTAINTY

Do you favor moving GAAP to a principles-based approach?



CFO magazine survey, June 2006

Going for the Records

In their efforts to reduce sick time and rein in soaring health-insurance premiums, companies have invested in a range of employee health and wellness programs. Now, several large employers have decided to attack the issue from a different angle: they've teamed with an Oregon-based nonprofit to offer workers an electronic health-record-keeping service intended to provide more-efficient medical care and avoid duplicative treatments.

Donating $1.5 million apiece to the effort, Pitney Bowes, Wal-Mart, Intel, and others have contracted with the Omnimedix Institute to build a database, to be known as Dossia, that will contain records from doctors, hospitals, pharmacies, and other sources. These comprehensive records would be the property of each employee, not of the employer, and would, proponents say, save time and money (including insurance premiums) while improving employees' medical outcomes. The National Association of Manufacturers is urging its members to sign on because, as Jeri Gillespie, NAM's vice president for human-resources policy, says, "businesses fund our health-care system, and any move that drives out waste is good both for employers and employees."

Not surprisingly, the concept has triggered concerns about privacy and accuracy. Omnimedix insists that the database will be secure, pointing out that it has hired experts not from the health-care field but from the banking industry. Privacy advocates counter that the banking industry has not been immune to data theft. "Medical-records systems, like banking systems, are prone to hacker attacks and improper disclosure," says Marc Rotenberg, executive director of the Electronic Privacy Information Center. "The systems are not adequately designed and the law does not provide adequate safeguards."

Deborah Peel, an Austin, Texas, psychiatrist who founded and chairs the activist group Patient Privacy Rights, agrees. "There is no law that guarantees that the promises big employers make are ones they have to keep," she says. Dossia is expected to be up and running sometime this summer. — *Rob Garver*

Six Stigma?

When Robert Nardelli was ousted as CEO of Home Depot, one unusual side effect was the attention paid to his advocacy of the Six Sigma process-improvement methodology. Consultancies, particularly those with competing approaches, were quick to offer opinions, surveys, and research intended to show that Six Sigma has been oversold. QualPro Inc., which markets a competing "multivariable testing" system, looked at almost five dozen companies that have adopted Six Sigma and found that the vast majority have underperformed the stock market. A recent study of finance shared-services organizations by The Hackett Group found that while fully 86 percent of them use Six Sigma or similar continuous-improvement methodologies, they generally achieve only incremental gains. To achieve what Hackett calls "world-class" performance, companies can't rely on Six Sigma alone; they must regard it as a specialized tool suitable to certain needs but far from a cure-all.

Scot Webster, vice president of global business solutions at Medtronic Inc., which deployed a combination of Six Sigma and Lean Manufacturing more than three years ago, agrees. "Six Sigma doesn't address everything," he says. "You have to use it in combination with other tools." But Medtronic did use its "Lean Sigma" methodology to reduce its payment-processing time by more than 50 percent.

Thomas Davenport, a professor of management and information technology at Babson College, suggests that in the current business climate, which is focused on growth and innovation, Six Sigma's emphasis on cost-cutting and efficiency might prove a harder sell. "Six Sigma is following the course of other methods, like Total

Quality Management: after awhile you start seeing cracks in its armor," he says. "Then something new comes along and companies rush to get it."

Critics have long contended that the further Six Sigma strays from its manufacturing roots, the less effective it becomes. — *Laura DeMars*

So Much for that Post-Enron Glow

You may not inspire as much confidence as you used to. According to a Watson Wyatt Worldwide survey of more than 12,000 workers at all job levels and across all industries, confidence in senior management's capabilities has dipped. Not surprising, you say, given the Enron scandal and an uncertain economy. Well, consider that between 2002 and 2004 the scores actually went up. What's going on? "Crises often lead to better communication," says Watson Wyatt's national practice director for organization effectiveness Ilene Gochman, "whether it's the 9/11 attacks, the dot-com crash, or financial scandals." At those times, she says, senior executives become more visible and get the message out. When they fail to do so, employees become less engaged and even disenchanted. At companies with what Watson Wyatt dubs a "highly engaged" workforce, confidence levels in senior management are 30-plus points higher. Good communication alone won't transform your workforce, Gochman says, but it will play a larger role than most senior executives believe. She says frequency is what matters most. And if you have actual good news to deliver, that can't hurt. — *Scott Leibs*

	2004	2005
Employees have trust and confidence in senior management.	51%	49%
Senior management makes changes to stay competitive.	57%	53%
Senior management takes steps to control costs.	59%	55%

Private Equity Attracts Public Scrutiny

As private equity gets hotter, it continues to attract heat. The latest wrinkle inspiring calls for increased regulation are so-called club deals, in which PE firms team up to bid for large companies.

Last fall, the Department of Justice sent letters to at least five high-profile private-equity firms, including Kohlberg Kravis Roberts, Merrill Lynch, and Silver Lake Partners, seeking information about such practices. The DoJ declined to comment on the informal investigation, but the agency is likely looking into whether the group deals employ bid-rigging or other anticompetitive practices. Clear Channel, HCA, and Kinder Morgan are among the companies that have been purchased recently by consortiums of PE firms.

Saikat Chaudhuri, a management professor at the University of Pennsylvania's Wharton School, says that the size and high profile of these deals is reaching a point where everyone starts to get a little nervous. While he doesn't expect regulators to step in any time soon, he says it is possible that the Securities and Exchange Commission may require PE firms to register as investment advisers and provide additional disclosures. Similar rules were proposed for hedge funds before the idea was killed by a Washington, D.C., appellate court last summer.

"I don't expect a big regulatory backlash," says Bruce Evans, a managing partner of PE firm Summit Partners, at least in part because the Sarbox-inspired flight of capital to foreign markets may cause regulators to be wary of a replay. Ironically, Europe seems more likely to crack down: in November, the UK's Financial Services Authority called for increased monitoring of private equity and threatened to limit the industry if it found the risk to financial markets excessive. Fears of a backlash against private equity increased in Germany last year when Franz Muntefering, then chairman of the Social Democratic Party, referred to PE firms as "locusts."

Private-equity firms here aren't taking any chances. Last month the Private Equity Council, a lobbying group that intends to improve the image of the industry and fend off any suggestion of regulation, officially opened for business. — *Joseph McCafferty*

Staking Out the Club

Large deals by private-equity groups are attracting attention.

Target	Buyers	Price*	Date
HCA	KKR, Bain, Merrill Lynch	$33	7/06
Harrah's Entertainment	Apollo Management, Texas Pacific Group	$28	12/06
Clear Channel	Bain, Thomas Lee	$27	11/06
Kinder Morgan	Goldman Sachs, AIG, Carlyle	$22	5/06
Freescale Semiconductor	Blackstone, Texas Pacific, Carlyle, Permira	$18	9/06

* Price (in $ billions) includes assumption of debt *Source: Various reports*

Healthy Debates

In February, San Francisco became the first jurisdiction in the country to require employers to offer paid sick days, but such laws may become contagious. With similar efforts pending in state and municipal legislatures across the country and Democrats in charge of both houses of Congress, a federal paid-sick-leave law is a distinct possibility.

Sen. Edward M. Kennedy (D–Mass.), who now chairs the Senate Committee on Health, Education, Labor, and Pensions, has indicated that mandatory paid sick leave is among his legislative priorities. Supporters of mandatory paid sick leave say they are confident that the Senate will hold hearings on the subject during this session and are marshalling their arguments accordingly. Many cite a 2005 study by the Institute for Women's Policy Research that claimed that providing U.S. workers with seven days of paid sick time annually would save the economy $8.3 billion by, among other things, reducing turnover and curtailing the spread of contagious illness.

Business groups dispute the claim and argue that, particularly in the case of small businesses, requiring paid sick time would prove detrimental to employees. "It would impinge on the employer's ability to offer higher salaries or other benefits that employees might actually prefer compared with paid sick leave," said Todd McCracken, president of the National Small Business Association.

As both sides prepare for battle, each will likely keep a close eye on San Francisco to see whether the city's experiment proves a model of progressive regulation or an object lesson in governmental interference. — *R.G.*

Verbatim

"I'm convinced that we need to eliminate [accounting] standards that are overly complex, difficult to implement...and difficult for the average investor to understand."

— SEC Chief Accountant Conrad Hewitt, addressing the 2007 Foundation of Accounting Education Conference

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Phasing Out Is In

As the first of the baby boomers approach retirement next year, much has been written about a potential worker shortage (see related story). That has triggered interest in ways to keep workers around longer, including a move toward "phased retirement," in which potential retirees assume part-time positions — and part-time pay rates — while collecting a portion of their pensions or other retirement benefits to supplement their decrease in pay.

With one-third of its 1,000 employees over the age of 50, Stanley Consultants has found phased retirement to be an attractive option for employees and the company alike. "It lets people ease into retirement while retaining a sense of professional challenge," says senior vice president and CFO Rick Smith. "And it helps us retain the expertise of this very knowledgeable group."

But companies interested in offering workers a phased-retirement option have encountered difficulty in creating comprehensive rules for implementing the scheme, not to mention uncertainty over some tax issues. Now the IRS is taking up the matter. Earlier this year, it issued Notice 2007-8, essentially a request for public comment as it addresses how to treat pension and similar distributions by older workers who remain in the workforce part-time. The Pension Protection Act of 2006 allows in-service pension distributions for workers aged 62 and above, but many believe that similar favorable treatment should be extended to workers below that age.

"The IRS notice is an important step for employers that want to allow their current employees to become phased retirees," says Mark Johnson, founder of ERISA Benefits Consulting. But he says companies can come at it from another angle as well: use the promise of part-time schedules to lure older workers from elsewhere. That way, he says, you gain valuable skills without having to deal with tax, pension, and defined-benefits issues. — *Kayleigh Karutis*

Reams Deferred

As executive-compensation schemes come under increasing scrutiny, nonqualified benefits plans are booming. Two recent studies say more companies are offering nonqualified forms of compensation to top executives, not only to boost those executives' retirement coffers but also as a way to lure and retain top talent.

The Todd Organization, an executive benefits consulting firm, found that 92 percent of the 276 companies it studied (based on *Fortune* magazine's "Most-Admired" list) offer some form of nonqualified plan, with nonqualified deferred compensation the most popular (see "Pay Me Later" at the end of this article). When MullinTBG, a provider of nonqualified executive benefits, asked companies why they offer such plans, 78 percent cited the need to attract and reward talented managers.

Nonqualified plans don't offer the same tax benefits as, say, a typical 401(k) plan, but they provide a way for participants to squirrel away far more money than do qualified plans. And popularity seems to breed popularity: nonqualified forms of compensation are now routinely benchmarked so that companies can gauge how their benefits offerings measure up against competitors'.

"They're a major part of the business world now," says Todd Organization president Ward Russell. Therefore, he says, CFOs should monitor aspects of their plans (such as matching contributions, which about half of all companies offer) to make sure the plans meet corporate goals for executive compensation. — *L.D.*

Pay Me Later

Prevalence of various aspects of nonqualified deferred compensation plans at select large companies.

- *86%* Voluntary deferrals
- *65%* At least one company contribution
- *48%* 401(k) match restoration
- *28%* Other match/discretionary contribution
- *18%* Fixed rate with yield above statutory rate
- *15%* Company stock as one choice

Source: The Todd Organization