# THE SHERIDAN ROAD MAP

*The Best Route to Financial Success*

June 2010 Volume 4 • Issue 6

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## YOU COMPLETE MY AUDIT

### Amid the tumult of Sarbanes-Oxley and thorny auditor-client issues lie long-lasting relationships, some that have endured for more than 50 years.

The relationship between accounting firms and their corporate clients has been shaky over the past decade, to say the least. In the wake of the Sarbanes-Oxley Act, accounting firms dumped some risky clients, shuttered ancillary consulting arms, and raised fees. That strained the collegial bond between firms and their clients.

More recently fees have dropped and it has become very much a buyer's market. At the same time, companies are demonstrating a new willingness to switch auditors. Last year, 1,331 public companies changed auditors, according to Audit Analytics; 82% of the time the client initiated the switch, versus the auditor dropping the account.

**Can We Talk?**

But amid all that tumult, many unions have endured — sometimes for more than a century. The longest-running relationship on record is between Deloitte & Touche and Procter & Gamble, which has employed only one primary audit firm since its incorporation in 1890. To crack the list of the 100 longest-lasting auditor-client relationships, your company would need to have used the same firm for more than 50 years.

Sarbox frowned on cozy auditor-client relationships by instituting the auditor-rotation rule, which requires lead audit partners to move off an account after five consecutive fiscal years. Lawmakers have occasionally toyed with the idea of also requiring companies to switch audit firms every few years, to further increase independence. Companies and auditors have both pushed back, arguing that the costs would outweigh the benefits and further cramp competition by limiting an already small pool of viable auditors. If such a rule ever did come to pass, it would spell an end to some very long-standing relationships.

### Together 4 Ever

*The longest-lasting relationships between public companies and accounting firms.*

| Company | Audit Firm | Auditor Since |
|---|---|---|
| Procter & Gamble | Deloitte & Touche | 1890 |
| Goodyear Tire & Rubber | Pricewaterhousecoopers | 1898 |
| Radioshack | Pricewaterhousecoopers | 1899 |
| Manulife Financial | Ernst & Young | 1905 |
| W.R. Grace | Pricewaterhousecoopers | 1906 |
| Bemis* | Pricewaterhousecoopers | 1907 |
| BP | Ernst & Young | 1908 |
| General Electric | KPMG | 1909 |
| Dow Chemical | Deloitte & Touche | 1910 |
| American Electric | Deloitte & Touche | 1911 |

*Based on CFO's analysis of data from Audit Analytics, as of April 6, 2010.*
**Bemis has used PwC and its predecessor companies since at least 1907.*

### A Loyalty Scorecard

*Of the 100 public companies that have stuck by their accounting firms the longest, here's how many each firm can claim.*

| Audit Firm | # of Companies |
|---|---|
| Pricewaterhousecoopers | 34 |
| Ernst & Young | 25 |
| Deloitte & Touche | 24 |
| KPMG | 14 |
| Grant Thorton | 1 |
| Rowles | 1 |
| Battelle & Battelle | 1 |

*Based on CFO's analysis of data from Audit Analytics, as of April 6, 2010. These relationships began between 1890 and 1952 and are still in effect today.*

*By Sarah Johnson • CFO Magazine, May 2010*

## Financial education is a multi-generational process

In last month's column, we explored potential damages to families and individuals when children of wealthy families grow up unprepared for responsibilities they'll inherit. While the stories of rich kids in trouble may fill tabloid pages, it represents a true failure for the families and a missed opportunity for key advisors to have steered everyone to a better outcome. For advanced planning teams working with a family where money maturity is in low supply, adding a family "money counselor" could not only help the parents and children but strengthen the foundation on which any financial plan is based and therefore increase its chances for success. Adding this professional dimension to the team also enhances the team's credentials for being comprehensive in its approach and differentiates it from other practitioners.

Financial literacy for the children of affluence starts early—just as models of nonproductive behavior do. Advisors to affluent families have observed the extraordinary pressures that many wealthy families put on the young, teen, and young adult children in the family to excel. Average performance in school, sports, social life, and career is not acceptable in families that consider themselves "above average."

While the pressures to surpass the ordinary are part of the family culture, the necessary skills are not necessarily present —creating children with emotional challenges if not depression. Very successful parents sometimes forget that they became successful because they had a lot of skills or they developed those skills in business or creativity or other factors that led to their success, according Dr. James Grubman, a therapist who works with wealthy families and advisors. "You have to teach kids skills from a very young age," he notes. "The prime age for learning good money skills and financial literacy is between ages of 6 and 14, which is much younger than most people realize."

*Financial literacy for the children of affluence starts early—just as models of nonproductive behavior do.*

**Beyond Good Intentions**

While parents may have good intentions for raising money-mature kids, they often fail to succeed because they don't move from soft intentions to a realized program of financial education tailored to the age and interests of the children. "The kids who do well have parents who've gone from good intentions to being intentional," observes Joline Godfrey, a consultant to affluent families on financial education and the head of Independent Means, Santa Barbara, CA. "Every parent has the good intention for their kids to grow up financially intelligent. But few of them really act on it. Those thought leader families who are committed and intentional and actually provide good financial education are the ones that have a different outcome. For example, when you look at what Warren Buffet has done [leaving his children some money but more assets going to their foundations for them to manage the charitable work], he's very clear what he expects from his kids."

Those families who pursue the preparation of the next generation for their responsibilities of wealth view it as an ongoing program, not just an afternoon discussion between tennis lessons and homework. Every year or every quarter, there are activities, plans, messages, everything they need to do in a very repetitive way over a period of time that helps ground the children in the basics of financial literacy appropriate to the family wealth factors and long-term responsibilities, such as philanthropic commitments. "I know I'm not working with a thought leader family when I get a request to come out for an afternoon to work with their kids," says Godfrey. "This is a process, it's not an event. One afternoon is going to have the kind of results that one would expect from that kind of half-hearted attempt."

**Families Gone Wild**

When family wealth counselors start their work they may quickly identify the children's lack of financial understanding, but they must first focus on the parents. Their spending habits, origins of wealth for both, and their attitudes toward affluence are all influential models for the children to observe long before any expert arrives. Old money parents who have never discussed money matters with their teenage children and spend moderately send one kind of signal. A quite distinct signal is sent by a first-generation wealthy entrepreneurial couple with teens old enough to have experienced the growth from mid- to high-net-worth and to live a family lifestyle that demonstrates aggressive spending. Each set of children would require a different approach to financial education.

"The reality is that most people who come to wealth do so in their lifetime," notes Grubman. "They're first-generation wealth, and they're sort of like immigrants to the land of wealth. They grow up in a lower economic environment and they wind up being very successful. Their kids, though, may have a different experience."

A single approach for all children in a family won't necessarily work either, since their relationships to money are completely different. Often, the older children—the first or second born—may have had experiences that enable them to remember more of the middle-class life than younger siblings (much as older immigrant children often have greater understanding of the family's native culture than children born in the U.S.). The youngest

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ones of the HNW and ultra-HNW families, though, may have grown up only when the family was affluent. They had different experiences than their brothers and sisters, who may only be five or six years older. What is sometimes attributed to personality for differences in good money-management skills among siblings may have more to do with birth order and the distinct family experiences they had during childhood.

"Every time I hear another horror story about a kid gone wild, I think, ah, family gone wild," observes Godfrey. "The family is not really providing the kind of direction, environment, activities, and learning that the children need. Every family takes for granted that if a child is going to be proficient at tennis or the clarinet, they need regular lessons, a great teacher, and practice. It's the same thing for financial education. And so, those kids who get practice, great instruction, and lessons do better."

Godfrey, for example, insists that she work with all generations of the family. Those parents who hope a financial education specialist can take their kids and tutor them may have good intentions, but they're not taking necessary actions to address the challenge. Parents and children must be involved. "To do it otherwise is just a waste of time and money," she notes. "Not every family has the appetite to take on this work. It's costly. It takes a fair investment of time. And it certainly requires all family members to begin to look at their actions in a different way. In general, there's certainly interest in financial education, but I think a lot of it is just trivial unless there's an ongoing commitment to the process. The commitment needs to be at least as powerful as the commitment to building a great tennis player."

**Use Kids' Passions**

Children who will inherit significant wealth and the responsibilities that go with it require world-class preparation. Balancing a checkbook and understanding compound interest is one thing, but managing assets is another. Mom may have built up a very successful regional chain of restaurants, but her twelve-year-old son and ten-year-old daughter may someday need to sit on the board and also approve the management of investments that support an extended family.

One way to engage children is to play off their passions; otherwise, financial education will feel like classroom instruction. Family wealth counselors work with the families to identify something the children already have an interest in and are willing to spend time pursuing, such as a favorite sport or activity, and develop a learning program around it as a theme.

Another approach to spark kids' interest in financial matters is using special group events. This month, for example, Godfrey is running a mother-daughter weekend called Fashion and Finance in New York. The idea is to get young women to engage in their own financial development. One of the sessions will examine the connections between Women's Wear Daily and the Wall Street Journal.

The end goal is to help each family member of the next generation to have an individual economic vision statement and the skills to realize it. While many families want their children to understand basic concepts and terms, the kids need to go beyond the introductory level to incorporate family values, such as those related to charitable giving or volunteering, and their particular interests in participating. The statement itself evolves as the children mature and become more focused in their interests.

**Strengthening the Financial Plan**

When a family wealth counselor works with the next generation of an affluent family, it helps ensure the orderly transition of financial planning from the parents to the children—and it enriches the ongoing relationships with the advanced planning team. Godfrey counseled a family that has a group of adult children and another set of younger children. The family had never done anything about financial education, but the parents understood they needed to get started immediately and worked with her to develop a program. Following a two-year plan, the adult children (including spouses) now meet each quarter for a weekend of master classes in such issues as philanthropy, investing, beneficiary development, stewardship, and careers. Between each quarter, Godfrey meets individually with the couples or individuals. In a parallel program, the adult children are also learning to be mentors to the younger children.

"It's learning decision-making about spending that's important —understanding how to have initiative and how to take risk, including how to learn from the mistakes," observes Grubman. "There are some basic financial literacy skills of life—how to be generous and charitable—and the job of parents is to manage their kids' apprenticeship around learning about money."

**Ten Skills Affluent Children Need by Age 18**

**How to:**

1. Save
2. Keep track of money
3. Get paid what you're worth
4. Spend wisely
5. Talk about money
6. Live on a budget
7. Invest
8. Exercise an entrepreneurial spirit
9. Handle credit
10. Use money to change the world

***Source:*** *"Raising Financially Fit Kids, " Joline Godfrey*

# The SEC Has a Few Questions for You

## Receiving a comment letter is no cause for panic, if you know what to expect.

It was a letter that Tom Cawley, CFO of Peet' Coffee & Tea, couldn't ignore.

Seven months after the company filed its 2008 annual report, there it was: a missive from the Securities and Exchange Commission seeking certain clarifications about the company's assumptions and business relationships.

That was the case for Cawley, who had to supply answers to 11 questions, including two minor points in the management discussion and analysis (MD&A) section of the company's 10-K. In his written response, Cawley disclosed the source for Peet's claim of a 12% uptick in grocery specialty-coffee spending and clarified his company's relationship with a coffee distributor.

That the SEC zeroed in on that facet of the 10-K did not surprise Cawley in the least. "The MD&A is the part that changes every year," he says. "It's talking about where the business is going, and where you've been, and what's driving the [underlying] economics." Indeed, the MD&A was the topic cited most frequently in 2009 by the SEC in its reviews of U.S. publicly traded companies' annual and quarterly filings, according to a CFO analysis of data compiled by Audit Analytics.

> *"For something we were not planning to address, 5 to 10 days of work and $15,000 to $20,000 of unbudgeted expenses is not necessarily insignificant."*
>
> **- Mark Haidet, *CFO Radiant Systems***

After the MD&A, the SEC has been focusing on two of the most controversial issues of the day: executive compensation and fair-value accounting. While most of the agency's concerns cluster around what might be considered a top 10 list of trouble spots (see "The SEC's Top 10 Concerns" at the end of this article), it also sends comment letters simply to ask for missing data that a company believes isn't material or doesn't apply to it (such as, in Peet's case, whether it has any off-balance-sheet arrangements), or to address current topics of concern. Today, for example, it may probe a firm's ties to business partners that operate in countries deemed state sponsors of terrorism.

The good news for companies is that when it comes to SEC comment letters, history does, in fact, repeat itself. "The top-10 list has been fairly consistent for at least the last five years," says Bridgette Hodges, partner in charge of SEC regulatory matters at Grant Thornton, who has been tracking SEC comment letters since 2004.

### Three Is the Magic Number

Ever since the SEC began making the letters public on the Edgar database six years ago, outside advisers, including accounting and law firms, have been helping companies stave off probing SEC queries by spotting trends and suggesting their clients add preventive disclosures.

The assistance is welcome because a company's likelihood of getting reviewed has increased in recent years. More than 2,200 companies received a letter last year on their quarterly and annual filings, a 73% increase over 2005, according to CFO's analysis. Under the Sarbanes-Oxley Act, the SEC must look at one filing from each public company at least once every three years. (The commission may also pay particular attention to certain types of companies at any given time, as well as to firms with the largest market caps or the most volatile stock prices.)

Although the commission may review a company's financials without offering its two cents, some CFOs say they expect to get an SEC letter addressed to them or their CEO every third year. If that letter contains only minor questions, finance executives take that as an indication that the lawyers, accountants, and controllers have "done a pretty good job of protecting us," Cawley says.

Still, the preemptive work doesn't always make a difference. "The scope of SEC comments depends on the SEC reviewers, what they're focusing on, how much time they have to focus on your company, and the latest hot-button issues at the time," says Gian-Michele a Marca, a partner at law firm Cooley Godward Kronish.

CFOs also measure the success of their correspondence with the SEC based on minimizing the amount of follow-up correspondence required. In a worst-case scenario, a review can lead to an amended filing or restatement. More often, it results in the company providing additional data and promising to give more detail in future filings.

Even if the process goes smoothly, the letters become an instant priority, distracting CFOs from other work and costing a sizable sum to boot.

"For something we were not planning to address, 5 to 10 days of work and $15,000 to $20,000 of unbudgeted expenses is not necessarily insignificant," says Mark Haidet, CFO of restaurant and hospitality technology provider Radiant Systems, who recently went through the comment-letter process. He says Radiant's costs were probably minor compared with other firms', since the latest round did not involve substantial questions.

### Qualms for 2010

For its part, the SEC usually hints at the areas its examiners will home in on shortly before the calendar fiscal year begins. Based on such hints, many of their 2010 questions should concern MD&A disclosures, non-GAAP financial measures, goodwill impairments, and risk disclosures tied to climate change.

Moreover, the SEC will continue to pry for more data on how companies pay their top people. Three years after issuing new guidance on pay, the regulator has promised to hold companies to a higher standard of disclosure. The SEC wants more information about incentive-pay performance targets, such as earnings per share, and companies' choice of peer

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# THE SEC HAS A FEW QUESTIONS FOR YOU *(continued from page 4)*

businesses. "Companies were not saying enough about the group of peer companies they're judging themselves against," says a Marca.

The increased scrutiny of the compensation discussion and analysis sections doesn't sit well with executives who feel they are unduly subject to the same regulations as financial institutions whose pay packages have been pilloried by the general public. "Most companies don't have compensation plans that are as complex or rich as AIG's or Lehman Brothers's," laments R. Don Elsey, CFO of Emergent BioSolutions, who was recently asked by the SEC to explain why the company adjusted its most highly paid executives' base salaries.

To be sure, CFOs aren't pleased with all the questions the SEC poses. Although they admit some queries are warranted, they also believe that most run counter to the SEC's vow to simplify financial reporting.

Indeed, as the commission continues to push for more information, and as accountants and lawyers continue to track the queries, companies are increasingly attempting to appease all parties by using boilerplate language and negative assertions. Notes Cawley, "The 10-Qs and 10-Ks and proxy statements are getting longer — but not necessarily more helpful."

## The SEC's Top 10 Concerns

1. **Management discussion and analysis.** The Securities and Exchange Commission wants more color in companies' descriptions of their operating results, their liquidity and capital resources, and how they develop critical accounting estimates. "Companies are still struggling with making their MD&As a story and not a recitation of the financial statements," says Bridgette Hodges, a Grant Thornton partner.
2. **Executive compensation.** Shelley Parratt, deputy director of the SEC's Division of Corporation Finance, warned last fall that companies not yet reviewed under 2006 pay disclosure rules will get their turn by the end of 2010.
3. **Fair-value measurements.** "Part of the [SEC] staff's job is to test the judgment of management," particularly at times when the fair value of an asset fluctuates, notes James Vieceli, a partner at law firm Manatt, Phelps & Phillips.
4. **Intangible assets and goodwill.** Companies were frequently questioned about their testing for goodwill impairment last year. Goodwill must be tested when a "triggering event," such as a drop in stock price, occurs. In that instance, "if fair value is depressed because of the downturn, you may need to take a charge," says Trevor Donelan, managing director at consultancy StoneTurn Group.
5. **Disclosure controls.** The regulator expects companies to use the exact wording in the certification rules for internal controls over financial reporting.
6. **Segment reporting.** The SEC frequently questions how a company breaks out its business units and notes inconsistent disclosures, according to Grant Thornton's review of 2009 comments.
7. **Non-GAAP measures.** The SEC is closely watching whether companies are using consistent figures in their analyst calls, press releases, Websites, and regulatory filings.
8. **Revenue recognition.** Questions usually address a company's accounting policy for recognizing revenue.
9. **Debt, warrants, and equity issues.** Queries center around valuations and proper disclosures.
10. **Related-party transactions.** The SEC often asks for additional disclosures to understand the nature of the transactions and the relationships involved.

*List based on SEC comment letters on U.S. companies' annual and quarterly filings dated between January 1, 2009, and January 1, 2010. Data based on CFO's analysis of Audit Analytics's comment-letter database, as of March 24, 2010.*

*By Sarah Johnson • CFO Magazine May 2010*

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